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Banking in Africa

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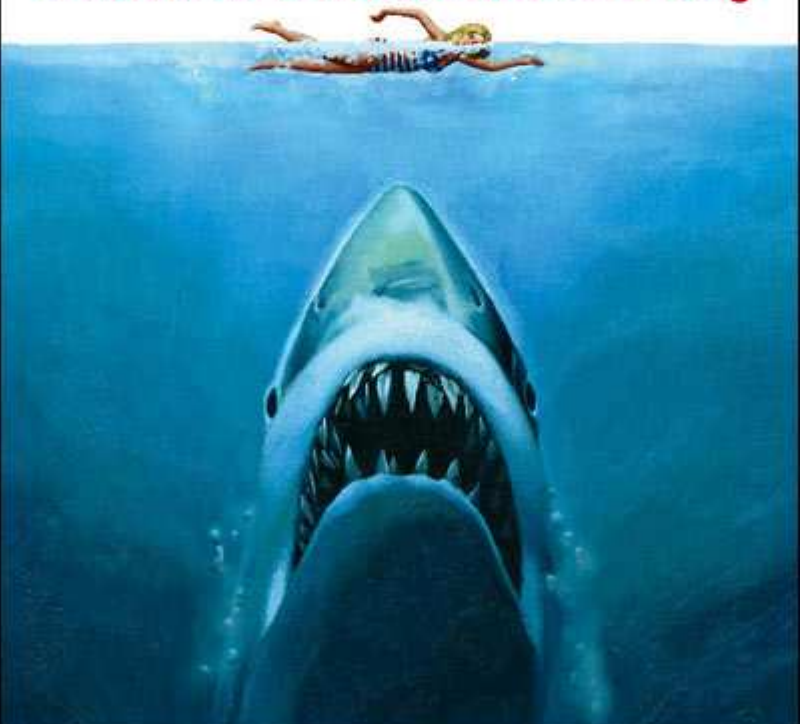
America's vulnerable economy



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Print Edition November 17th 2007

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America is vulnerable to recession. Can booming emerging markets save the world economy? leader

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Politics this week

Nov 15th 2007
From The Economist print edition

AP

Pakistan's **General Pervez Musharraf** said that he would hold elections on January 9th and his attorney-general said he would resign his army post soon. But he refused to say when martial law would be lifted. Benazir Bhutto, a former prime minister placed under house arrest, pulled out of talks with the general and demanded he resign as president. Nawaz Sharif, her erstwhile rival, joined forces with her in opposition. See article

A bomb exploded inside the **Philippines'** House of Representatives. Four people died in the blast, including a congressman and former Muslim rebel who had backed military operations against Abu Sayyaf, a guerrilla group with links to al-Qaeda.

Kuala Lumpur saw its largest anti-government demonstrations since 1999, protesting at dubious election procedures and alleged corruption within the electoral commission. See article

Ieng Sary, foreign minister in Cambodia's genocidal **Khmer Rouge** government, was finally arrested by the Khmer Rouge Tribunal, a UN-backed war-crimes court. See article

Yahoo! settled out of court with the families of two Chinese dissidents who were jailed after the firm identified them to Chinese authorities. Both were sentenced to ten years' imprisonment, and are still in jail.

Heavy-handed

Seven Fatah supporters were shot dead by Hamas policemen during a rally in the **Gaza Strip** on November 12th, held to commemorate Yasser Arafat, the Palestinian leader and founder of Fatah. Mahmoud Abbas, the Fatah president of the Palestinian Authority, compared the actions of Hamas to the “crimes of the Israeli occupier”. See article

President Mahmoud Ahmadinejad of **Iran** denounced domestic opponents of the country's controversial nuclear weapons programme as “traitors”. His words were aimed at his conservative critics as much as reformists. See article

Thousands more civilians have fled the fighting in North Kivu province in eastern **Congo** between the army and rebels of General Laurent Nkunda. Some 500,000 have been displaced since the start of the year in what aid agencies warn is a major humanitarian crisis. See article

A report from the World Bank on **Africa's economic development** was broadly optimistic about the continent's prospects after a decade of 5.4% growth, roughly in line with global rates. But it also gave warning of growing imbalances between the big oil-exporting countries, which are riding a boom in commodity prices, and the rest.

Down tools, lads

AFP

France was brought to a near-standstill for the second time in a month by strikes against plans to reform public-sector pensions. Transport and power workers began the action, but were soon joined by other public-sector workers. President Nicolas Sarkozy promised to stick to his plans, but negotiations started over the details. See article

The **Georgian government** announced an end to the state of emergency that

it imposed after five days of street demonstrations. President Mikheil Saakashvili has called an early presidential election on January 5th. See article

Franz Müntefering, **Germany's** vice-chancellor, stepped down, saying that he wanted to care for his sick wife. Mr Müntefering, a Social Democrat, recently lost a fight to stop his party leader, Kurt Beck, from moving leftwards. His resignation is likely to increase tensions within the grand coalition between the Social Democrats and Chancellor Angela Merkel's Christian Democrats. See article

The ruling centre-right coalition under Anders Fogh Rasmussen won re-election in **Denmark** by the narrowest possible margin. But Mr Fogh Rasmussen may not serve out a full third term. See article

There were widespread football riots in **Italy** after a young Lazio fan was accidentally shot dead by a policeman. Football games in the league's lower divisions were suspended for a week.

The new man

Michael Mukasey was sworn in as America's attorney-general, replacing Alberto Gonzales, who resigned in August amid accusations of incompetence. Mr Mukasey immediately began an investigation into the Justice Department's role in President George Bush's warrantless eavesdropping programme.

A Nevada justice of the peace ruled that **O.J. Simpson**, a former American football star, must stand trial on charges of kidnapping and armed robbery. He is accused of trying to steal sporting memorabilia from a Las Vegas hotel.

For the first time, **the Senate** overrode a veto by President Bush. It insisted on passing a $23 billion water-resources bill which the president had said was too expensive.

The House of Representatives voted to approve a $50 billion **war-funding bill**. If passed, it would require Mr Bush to start withdrawing troops from Iraq in 30 days, but the president, who had asked for $200 billion, has promised to veto it.

Undiplomatic

The **Ibero-American summit** of 19 Latin American countries plus Spain and Portugal was enlivened by a verbal spat between Spain and Venezuela. Spain's monarch, King Juan Carlos, told Venezuela's president, Hugo Chávez, to “shut up” when he persistently interrupted José Luis Rodríguez Zapatero, the Spanish prime minister. The king later walked out when Nicaragua's president, Daniel Ortega, criticised Spanish businesses. See article

The government of **Uruguay** gave permission for a $1.2 billion paper factory built by Botnia, a Finnish firm, to start operating. The decision prompted a protest march by 20,000 Argentines who fear the plant will pollute a river that both countries share, something Uruguay disputes.

AP

Cristina Fernández de Kirchner, **Argentina's** president-elect, named a new cabinet. Several powerful ministers from the cabinet of her predecessor and husband, Néstor Kirchner, kept their jobs.

Canada's Conservative prime minister, Stephen Harper, promised an inquiry into allegations by a German-Canadian arms-dealer and lobbyist that he paid $300,000 to Brian Mulroney, a former Conservative prime minister. Mr Mulroney denies any wrongdoing and has himself called for an inquiry into the claims.

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Business this week

Nov 15th 2007
From The Economist print edition

The shift in strategy by Arun Sarin, boss of **Vodafone**, appeared to be vindicated when the mobile-phone giant raised its sales and profit forecasts thanks to faster growth in India and Turkey, as well as higher revenue from mobile-data services in Europe. Net income in the six months to September was £3.3 billion ($6.6 billion), after a loss of £5.1 billion a year earlier. That beat analysts' estimates.

BHP Billiton, the world's biggest mining company, promised a $30 billion share buy-back if its takeover of **Rio Tinto,** the industry's number three, which is largely owned by British investors, is successful. The mining giant wants half of the combined company to be owned by Australian investors to preserve its Australian character and take advantage of tax credits. See article

European Union antitrust regulators began a full investigation of **Google's** $3.1 billion bid for **DoubleClick**, an online-advertising company, saying a preliminary investigation showed the deal would raise competition concerns. The deadline for a verdict is April 2nd. America's Federal Trade Commission is also reviewing the takeover.

The EU's consumer-affairs commissioner said that an investigation of advertising and other practices by websites selling **airline tickets** had shown “irregularities” at over 50% of sites looked into. The probe covered Europe's leading airlines and low-cost carriers, as well as other websites selling airline tickets.

Off the rails

Germany's government said the continuing rail strike could do much harm to the country's economy if it does not end soon. It called on **Deutsche Bahn**, the state-owned railway, and the train drivers' union to return to the negotiating table. The union threatened an indefinite strike should Deutsche Bahn fail to improve its wage offer.

While France too was in the throes of a transport strike, a high-speed **Eurostar** train, named “Tread Lightly”, left London's restored St Pancras station for the first time and arrived at the Gare du Nord in Paris in two hours and 15 minutes. A few minutes later the first Eurostar zoomed into St Pancras from Brussels.

Head of the herd

John Thain, chief executive of NYSE Euronext, agreed to take the top job at **Merrill Lynch**. Mr Thain was among the senior staff at Goldman Sachs before taking over as chief executive of the New York Stock Exchange, which he took public and merged with Euronext, a European exchange group. NYSE Euronext plans to name Duncan Niederauer, one of its chief operating officers, as its new chief executive. See article

Bear Stearns will take a $1.2 billion write-down in the fourth quarter because of bad loans in its credit portfolio. Meanwhile **HSBC** gave warning that the blight of souring mortgage debt is spreading to credit-card and other consumer loans, forcing the bank to set aside $3.4 billion, 70% more than it had bargained for three months ago. **Barclays** announced a write-down of £1.3 billion ($2.7 billion) on credit-related securities, less than had been feared.

E*Trade, an American discount stockbroker which diversified into banking, admitted that its profits would be hit by mortgage losses. After a critical report by an investment analyst, its share price fell by 59% in one day.

Ben Bernanke, chairman of the **Federal Reserve**, unveiled sweeping changes to the American central bank's forecasting practices. The Fed will make economic projections for three years instead of two and distribute them four times a year instead of twice in an effort to help households and businesses

understand the outlook for interest rates and inflation. See article

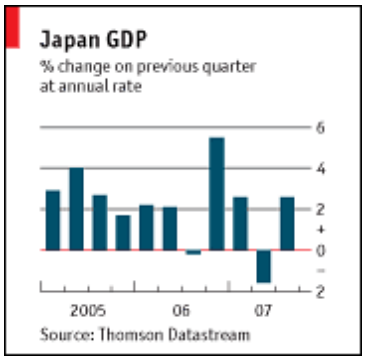
Spend and save

Wal-Mart shares jumped 6% after the American supermarket giant beat expectations with a third-quarter profit of $2.9 billion on sales of $91 billion. After unsuccessful attempts to lure higher-paying customers, it has gone back to its core strategy of low prices and tight inventories.

The value of **American retail-sales growth** slowed in October as consumers held their purse strings tight because of worries about recession. Sales of home furnishings were particularly weak.

Bigger in Japan

Helped by robust exports to other Asian countries, **Japan's economy** expanded at an unexpectedly strong pace in the latest quarter. GDP increased by 0.6% in the third quarter; in the second, it shrank. The yen's weakness is helping Japanese exporters—although the currency has risen against the dollar in recent weeks. The **euro area's economy** also expanded more quickly than expected in the third quarter. GDP in the currency zone grew by 0.7% in the three months to September.



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KAL's cartoon

Nov 15th 2007
From The Economist print edition

Illustration by Kevin Kallaugher

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Recession in America

America's vulnerable economy

Nov 15th 2007
From The Economist print edition

Recession in America looks increasingly likely. Can booming emerging markets save the world economy?

Get article background

IN 1929, days after the stockmarket crash, the Harvard Economic Society reassured its subscribers: “A severe depression is outside the range of probability”. In a survey in March 2001, 95% of American economists said there would not be a recession, even though one had already started. Today, most economists do not forecast a recession in America, but the profession's pitiful forecasting record offers little comfort. Our latest assessment (see article) suggests that the United States may well be heading for recession.

Granted, GDP grew by a robust 3.9%, at an annual rate, in the third quarter. Granted also, revisions may well push this figure up. But that was the past. More timely signs suggest that the economy could stall in this quarter. By early next year, output and jobs could be shrinking. The main cause is the imploding housing market. Experts said that house prices could never fall nationwide. But fall they have, by 5% in the past 12 months. Residential investment has collapsed, but a glut of unsold homes means that prices have much further to drop. Americans' spending is likely to be dented much more by a fall in house prices than it was in 2001 by the stockmarket's collapse. With house prices lower and credit conditions tighter as a result of the subprime crisis, households can no longer borrow against capital gains to support their spending.

Dearer oil is set to squeeze households further (this week's drop in crude prices notwithstanding). Consumer confidence has already fallen sharply. It cannot be long before consumer spending stumbles, which in turn would hurt companies' profits and investment. The weak dollar will boost exports, but at only 12% of GDP, exports are too small to make up for a weakening of consumer spending, which accounts for 70%.

I want to break free

Will an American recession drag the rest of the world down with it? The economies of Europe and Japan rebounded strongly in the third quarter, but look likely to slow down. Although both should be able to keep chugging along, neither is likely to set any great pace. Strengthening currencies will hurt exporters in both places. Europe's own housing hotspots are cooling, and some of its banks have been sideswiped

by America's subprime ills.

The best hope that global growth can stay strong lies instead with emerging economies. A decade ago, the thought that so much depended on these crisis-prone places would have been terrifying. Yet thanks largely to economic reforms, their annual growth rate has surged to around 7%. This year they will contribute half of the globe's GDP growth, measured at market exchange rates, over three times as much as America. In the past, emerging economies have often needed bailing out by the rich world. This time they could be the rescuers.

Of course, a recession in America would reduce emerging economies' exports, but they are less vulnerable than they used to be. America's importance as an engine of global growth has been exaggerated. Since 2000 its share of world imports has dropped from 19% to 14%. Its vast current-account deficit has started to shrink, meaning that America is no longer pulling along the rest of the world. Yet growth in emerging economies has quickened, partly thanks to demand at home. In the first half of this year the increase in consumer spending (in actual dollar terms) in China and India added more to global GDP growth than that in America.

Most emerging economies are in healthier shape than ever (see article). They are no longer financially dependent on the rest of the world, but have large foreign-exchange reserves—no less than three-quarters of the global total. Though there are some notable exceptions, most of them have small budget deficits (another change from the past), so they can boost spending to offset weaker exports if need be.

This does not mean emerging economies will grow fast enough to make up for the whole of a fall in America's output. Most of them will slow a bit next year: for instance, China's growth rate may dip to “only” 10%. So global growth will ease—which, after five years at an average of almost 5%, close to its fastest pace ever, it needs to do. But thanks to the vigour of the new titans, it will stay above its 30-year average of 3.5%.

A tale of two prices

The rising importance of the world's new giants will not only boost growth. It will also shift relative prices, notably those of oil and the dollar. And the consequences of this will be less comfortable for developed countries, especially America.

The oil price has risen mainly because of strong demand in emerging economies, which have accounted for as much as four-fifths of the total increase in oil consumption in the past five years. In past American recessions the oil price usually fell. This time it is likely to hold up. That will not only hurt the finances of Western consumers, but may also make the jobs of their central bankers harder, by combining inflationary pressure with economic slowdown.

The enfeebled dollar—lately in sight of $1.50 to the euro—would be weaker still without enormous purchases by central banks in emerging economies. This support is now waning. China and others are putting a smaller share of increases in reserves into the American currency. And Asian and Middle Eastern countries with currencies linked to the dollar are facing rising inflation, but falling American interest rates make it harder to tighten their own monetary policy. They may have to let their currencies rise against the sickly greenback, meaning they will need to buy fewer dollars. More important, as international investors wake up to the relative weakening of America's economic power, they will surely question why they hold the bulk of their wealth in dollars. The dollar's decline already amounts to the biggest default in history, having wiped far more off the value of foreigners' assets than any emerging market has ever done.

The vigour of emerging economies is good news for the world economy: for its growth, it has much less need of a strong America. The bad news for America is that this, in turn, may mean that the world also has less need of the dollar.

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Climate change

Green protectionism

Nov 15th 2007
From The Economist print edition

A dangerous flaw in a bill to control carbon emissions

Illustration by Claudio Munoz

FOR those (such as this newspaper) who argue that the only way to avert dangerous climate change is to set a price on CO_2 emissions, what's going on in America's Congress is excellent news. A bill to set such a price has achieved a remarkable degree of cross-party support (see article). Federal emissions controls in America are essential to tackling climate change globally. So it is especially unfortunate that the bill includes a provision that would turn the fight against climate change into a tool for protectionists.

While Al Gore has been strutting his stuff on stage, behind the scenes America's quieter greens have been successfully lobbying powerful interests. Many companies have come round to the view that they would do better with a single federal system than a patchwork of state-level rules. Farmers have bought the idea that they can make money out of biofuels. Christians have been persuaded that they need to be better stewards of the earth. Defence hawks have been arguing that America needs to reduce its dependency on the Middle East. But two powerful groups have remained determinedly sceptical: energy-intensive manufacturers and organised labour, who fear the effects of higher energy costs in America and their impact on jobs.

The main purpose of the bill is to establish a carbon price through a cap-and-trade system. The proposal is a reasonable one, informed by the experience of Europe's similar scheme. But to placate the manufacturers and the unions, the bill also includes a measure which Europe has rightly abjured (although some member states have recently been demanding one) for a border tax on carbon-intensive goods. Imports would have to be certified as to their carbon content, and would be taxed accordingly.

Proponents of the idea argue, first, that American producers would otherwise be disadvantaged by the higher costs that their country's stricter standards impose on them. Second, they maintain, a tax would encourage developing-country governments to cut the carbon-intensity of their economies for fear of losing lucrative export markets.

Be green and grow

On the first argument, if America establishes a carbon price, an energy-intensive industry such as aluminium would very likely choose to expand capacity elsewhere. Yet it is not clear that, in the long run, environmental regulation does much to suppress economic growth. After all, California imposes tighter rules on companies than do most other American states, but its long boom suggests that greenery and growth can coexist comfortably.

China and India might well come more swiftly to the negotiating table if they faced the possibility of losing their export markets. But the experience of America and Europe suggests that threatening trade sanctions is not the only way to bring a country round. After all, Europe set a carbon price without imposing tariffs on American goods, and America looks like following its lead anyway. What's more, the costs of a border tax could be huge, not just because of the massive bureaucracy needed to certify the carbon content of different goods imported from different factories in different countries, but also because such a tax would be a dangerous weapon in the hands of America's growing gang of protectionists.

The people who worry most about the costs of trying to constrain carbon emissions are the very ones demanding protectionist measures. But if those measures are passed, America risks something far costlier than a switch to cleaner energy: a global trade war.

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France

Sarkozy's Thatcher moment

Nov 15th 2007
From The Economist print edition

Why Nicolas Sarkozy cannot afford to yield to French strikers

AP

Get article background

THE effervescent French president, Nicolas Sarkozy, has been on the road a lot recently—in Morocco, Chad, America, Russia and Germany, among other places. There has been much approving commentary about how French foreign policy has been freed of the reflexive anti-Americanism it so often bore under Mr Sarkozy's predecessor, Jacques Chirac. Yet for the future of his country, and of his presidency, Mr Sarkozy's foreign policy is not what counts most.

A far bigger test confronted Mr Sarkozy at home this week, as his much-vaunted economic reforms provoked a string of big strikes, already started by the rail unions and power workers, to be followed in short order by civil servants, teachers and even magistrates. This is being talked of as Mr Sarkozy's Thatcher moment. Parallels with the iron lady as she faced down Britain's coalminers in 1984-85 are inexact. Yet Mr Sarkozy is being watched closely in other continental European countries whose readiness to reform seems to have faded (German rail unions have also been on strike this week). More than the future of France is at stake.

The fearsome power of the French street has become the stuff of legend. Unionisation of the workforce remains surprisingly low—below British, German and even American levels. Yet at least since 1968 (some would go back further, to 1789), strikers and demonstrators have had an almost mystical status in France. In a political system that emasculates parliament and gives the president quite extraordinary power, public protests are one of the few avenues for genuine opposition. Yet the latest strikes are cruder in purpose than this observation implies. Far from representing a broad-based opposition, they stand for the narrow bloody-mindedness of vested interests determined to protect their excessive privileges.

Against this group Mr Sarkozy can marshal some strong arguments. His presidential campaign this year was unusually specific. He pledged to get France back to work, to scrap exorbitant public-sector privileges, to cut taxes and to set free a strangled labour market. He promised to end the “special regimes” that pay generous pensions to certain parts of the public sector, including the rail, electricity and gas industries. He said he would introduce a new law, due to take effect next year, to guarantee minimum levels of public service during strikes. Mr Sarkozy was admirably clear about his intentions, and he won an equally clear electoral mandate in May.

His proposals for reform were much more detailed than the vague ones Margaret Thatcher set out in her first election manifesto in 1979. They also represented a clear break with Mr Chirac, who did not run as a

reformer in either 1995 or 2002. The truth is that Mr Chirac never really believed that radical change was necessary to improve the French economy and to cut unemployment. Mr Sarkozy does. Moreover, in contrast to the French people's tepid attitude in 1995, when Mr Chirac's first government tried to reform the special regimes for pensions, only to back down in the face of protests, the public now offers Mr Sarkozy firm support (see article). Often in the past the voters have, perversely, blamed the government, not the unions, for strikes and disruption—but not, so far, this time.

Mr Sarkozy has also chosen his battlefield with some skill. He wants to attack many privileged groups, but is starting with the most egregious. The special regimes are inordinately generous, allowing many workers to retire on full pensions at the age of 55, and some as early as 50. And, in yet another echo of Lady Thatcher, he has learnt from previous experience. In 1984 she knew that Edward Heath had, in the 1970s, twice taken on the miners and lost, leaving his government discredited, so she prepared the ground carefully for her own clash. Mr Sarkozy knows what happened to Mr Chirac in the mid-1990s and seems determined not to repeat his practice of offering unwise concessions, at least for now.

Don't give in

It is those qualifying phrases—so far, for now—that are worrying. Voters can be fickle. Already Mr Sarkozy's popularity rating has fallen. The insiders who resist reform tend always to be more vocal and articulate than the outsiders who would benefit from it. And, although Mr Sarkozy has embraced the case for change, his instincts are not at all those of a free-market Thatcherite. He displays too many of the traditional French predilections: a belief in a big role for the state, a partiality for (often state-owned) national champions, a mistrust of the benefits of unfettered competition.

Above all, Mr Sarkozy is by nature a deal-maker, a man disposed always to look for compromise. Sometimes that is an advantage. But in the confrontation that he now faces, it is not. In the summer he watered down plans for university reform; he has just offered special tax breaks to striking fishermen. He cannot afford to back away similarly from his promised reforms to the public sector and the labour market, even in the face of prolonged strikes. It would be an exaggeration to say that this is France's last chance to change. But as the appetite for economic reform wanes across Europe, it is the last that is likely to come for a long time.

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Pakistan

A coup from Wonderland

Nov 15th 2007
From The Economist print edition

Neither democracy nor stability in prospect

Reuters

Get article background

IN THE topsy-turvy logic of General Pervez Musharraf, it takes an army dictator to deliver democracy to Pakistan—and a spell of martial law to safeguard the constitution. Or so Pakistan's president seemed to suggest this week, in a series of impassioned efforts to justify his second seizure of power, on November 3rd. How to deal with such a man?

America's idea had been to urge him to share power with Benazir Bhutto, leader of the Pakistan People's Party (PPP). According to this plan, the general would have stood down as army chief on November 15th, as the constitution had required. He would then have held an unrigged election in January, which the PPP would hope to win. The PPP might then have formed a government supportive of the general.

The scheme was supposed to balance short-term security with the needs of long-term stability. It would have left General Musharraf as a strong civilian president, committed to fighting Islamist militancy, including a runaway Taliban insurgency on the north-western frontier with Afghanistan. It would also have given Pakistan a more legitimate government than it has enjoyed since the general launched his first coup, in 1999. These two benefits are related. As Pakistan's most liberal party, the PPP would offer better support for General Musharraf's terror-fighting than he has hitherto found.

A halfway representative government might also start healing Pakistani grievances. Sixty years after it was cobbled together—by the idea of a Muslim homeland in South Asia that perhaps only a minority subscribed to—the country is dreadfully divided. In western Baluchistan, a flickering separatist insurgency is flaring. On the frontier, Pushtun nationalism and anti-Americanism boost the Taliban. The general and his Punjab-dominated army cannot fix these problems.

Indeed he has exacerbated them by attacking the civil institutions that hold the country feebly together. Even before his coup, he ruled more or less by decree. Parliament has been reduced to a facile talking-shop. And his latest wrecking-job on the judiciary is impressive even by his own standards. Of 17 Supreme Court judges, 12 have been dismissed since his coup. Several, including the chief justice, Iftikhar Chaudhry, are under arrest. They have all been replaced with army-picked sycophants. Indeed, it was for this purpose that General Musharraf grabbed power: Mr Chaudhry had developed a bad case of judicial independence.

Though still in uniform, which the constitution seemed to frown on, the general got himself re-elected

president by Parliament last month. On the eve of his coup, the judges were due to give a ruling on whether this was legal. To forestall their judgment, the general in effect declared martial law. He has since taken private television news channels off the air, arrested several thousand opposition politicians, lawyers and human-rights workers, and issued orders for civilians to be tried by military courts.

Cornered

To its credit—and the surprise of jaded Pakistanis—America has strongly condemned this outrage. It insists that the general restore the constitution and return to the plan: to ditch his uniform and hold an election soon. General Musharraf, as if in a spirit of compromise, has suggested he will lose his uniform just as soon as his new pet judges bless his re-election. He also says the general election will be held in January. But he refuses to say when he will restore the constitution—and suggests it will not be until after the poll.

This is unsurprising. Unless he can rewrite the constitution to account for his actions he runs the risk that they will be reversed—and he will be held accountable for them. Three former Pakistani coupsters, including General Musharraf himself, have encountered this problem. Their solution was always the same: hold a rigged election under martial law; blackmail Parliament into changing the constitution to order; and, as a reward, restore it.

But an election held under martial edicts would be a farce—no matter what clothes the general happens to be wearing. A poll held under the constitution, but adjudicated by the new judges, would also be unlikely to be seen by Pakistanis as free and fair. Almost every opposition party except the PPP has said it will boycott the election. Miss Bhutto, put under house arrest this week, says she may do the same (see article).

This promises worse mayhem. To avert it, General Musharraf should restore both the constitution and the sacked judges. He must also honour his promise to disrobe and hold a fair election. If the judges then rule that his presidential re-election was illegal, so be it. His choice would be to quit, or offer himself to the next Parliament as a civilian candidate. Failing these steps, Pakistan will be neither stable nor secure.

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Georgia

Misha's mess

Nov 15th 2007
From The Economist print edition

Mikheil Saakashvili's crackdown has outraged his friends. What should they do now?

EPA

Get article background

MOST ex-Soviet countries have already abandoned the idea that rapid economic and political reform can bring a future based on openness, freedom and legality. Some (such as Ukraine) are stuck in political stalemate. Others (such as Russia) have turned to what the Kremlin calls “sovereign democracy”—crony capitalism laced with nationalism. Now Georgia, which until recently was one of the few bright prospects left, risks turning into yet another ill-run country with a corrupt elite squabbling over the spoils of office.

This is not a total surprise. Since the 2003 “rose revolution” that swept him into power, President Mikheil Saakashvili's weaknesses have included impetuousness, self-indulgence and a reliance on too narrow a circle of advisers. But until now these seemed to be outweighed by his drive, vision and charm—and the spectacular successes of his deregulation and free-market reforms.

Now the balance has tipped. Unleashing riot police on demonstrators, leaving dozens in hospital, then declaring a state of emergency, seem an inexplicable overreaction to protests that posed no threat to public order. Blanket bans on demonstrations and on anti-government radio and television are tactics that would raise blushes even in the Kremlin.

Mr Saakashvili claims his country was facing a putsch organised by outside provocateurs. Though Georgia has certainly suffered much from Russian mischief-making, he has produced no convincing evidence that it has played a decisive part in recent days. Having cried wolf, he may find it harder to win outside attention when his country faces a genuine threat.

His decisions to call an early presidential election on January 5th and to lift the state of emergency (see article) are not big concessions. The election looks like a cynical stunt to capitalise on the opposition's divisions and unpreparedness, in conditions in which the contest can hardly be free or fair. Although the opposition has now found a candidate, the president's command of the media and the state's resources is likely to assure him an easy victory; it will not be a democratic mandate. Rigged elections are a favourite tool of tyrants.

Is anybody paying attention?

The West has been shamefully slow to condemn the abuse of power by its protégé, “Misha”. America and the European Union have expressed some regret and called for calm, but they have not said bluntly and publicly that the Georgian authorities' use of force is unacceptable. They should. It would also be worth

investigating how the foreign aid showered on Georgia has been spent. It is not just that some may have leaked away on mistresses and Mercedes cars. It would be a sad business if American tax dollars had paid both for the security forces' training and equipment and for the broadcasting facilities that they recently smashed up.

Georgia's friends should also urge Mr Saakashvili to postpone the presidential vote, and instead hold a fair, internationally supervised parliamentary election in the spring. The speaker of parliament, Nino Burjanadze, who retains the statesmanlike image that Mr Saakashvili has lost, should convene talks between all political forces, at first to reach agreement on election rules, then to discuss constitutional changes. A new parliament should take back some of the powers that the presidency has recently misused. Until that happens, Mr Saakashvili should be in political quarantine. Any planned official visits to Western capitals, and particularly to Washington or Brussels, should wait until Georgia has returned to normal.

This is not just about salving Western governments' wounded feelings. Failure to criticise Mr Saakashvili's mistakes will undermine the West's cause throughout the region. Russians will wonder whether outside support for Georgia in recent years was a cynical bit of Kremlin-bashing and energy politics, rather than good-hearted help for a country yearning for security and freedom.

Yet even as they urge Georgia's leader to change course, Europe and America should also bolster the country's security. One reason for twitchiness in Mr Saakashvili's inner circle is a feeling that Georgia faces a threat from a resurgent Russia, and the West is a wobbly ally. The latest shenanigans must not send the Kremlin a signal that Georgia is up for grabs. A NATO summit in Bucharest in April is due to consider the conditions for Georgia, eventually, to join. Any offer must not give Mr Saakashvili a free ride. Membership would require not only continued development of Georgia's well financed armed forces, but also the entrenchment of NATO's central values: the rule of law and political pluralism. The path to membership is likely to be longer and tougher, thanks to Mr Saakashvili's blunders. But these must also not give Russia any veto over Georgia's future.

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Mobile banking

A bank in every pocket?

Nov 15th 2007
From The Economist print edition

Banking on mobile phones holds promise, provided regulators are willing to be flexible

eyevine

Get article background

THE idea that mobile phones bring economic benefits is now widely accepted. In places with bad roads, few trains and parlous land lines, they substitute for travel, allow price data to be distributed more quickly and easily, enable traders to reach wider markets and generally ease the business of doing business. Leonard Waverman of the London Business School has estimated that an extra ten mobile phones per 100 people in a typical developing country leads to an extra half a percentage point of growth in GDP per person. To realise the economic benefits of mobile phones, governments in such countries need to do away with state monopolies, issue new licences to allow rival operators to enter the market and slash taxes on handsets. With few exceptions (hallo, Ethiopia), they have done so, and mobile phones are now spreading fast, even in the poorest parts of the world.

As mobile phones have spread, a new economic benefit is coming into view: using them for banking (see article), and so improving access to financial services, not just telecoms networks. Pioneering m-banking projects in the Philippines, Kenya and South Africa show the way. These “branchless” schemes typically allow customers to deposit and withdraw cash through a mobile operator's airtime-resale agents, and send money to other people via text messages that can be exchanged for cash by visiting an agent. Workers can then be paid by phone; taxi-drivers and delivery-drivers can accept payments without carrying cash around; money can be easily sent to friends and family. A popular use is to deposit money before making a long journey and then withdraw it at the other end, which is safer than carrying lots of cash.

There is no need to set up a national network of branches or cash machines. M-banking schemes can be combined with microfinance loans, extending access to credit and enabling users to establish a credit history. Some schemes issue customers with debit cards linked to their m-banking accounts. All this has the potential to give the “unbanked” masses access to financial services, and bring them into the formal economy.

What can governments do to foster m-banking? As with the spread of mobile phones themselves, a lot depends on putting the right regulations in place. They need to be tight enough to protect users and discourage money laundering, but open enough to allow new services to emerge. The existing banking model is both over- and under-protective, says Tim Lyman of the World Bank, because “it did not foresee the convergence of telecommunications and financial services.”

In many countries only licensed banks are allowed to collect deposits. Even if a mobile operator forms a partnership with a bank, its agents may have to comply with banking rules covering everything from the height of the counter to the installation of alarms. Financial institutions may have to provide detailed statements to the central bank every week, which is tricky for organisations with agents in remote areas. Some countries have rigid rules on the documents demanded of anybody opening an account, which excludes many.

Follow the Filipinos

Some of these rules, which are based on an outdated view of what banking looks like, should be relaxed. Allowing institutions other than banks to enter the market makes sense, provided regulatory oversight and consumer-protection measures are in place. Strict proof of identity may not be needed for some customers, given the small sums involved. And existing m-banking schemes set a limit on the size of transactions that is low enough to deter money-launderers but high enough to satisfy most customers.

The regulatory approach being taken in the Philippines provides a good model for other countries. Rather than trying to work out the best rules in advance, which could hamper innovation, the regulator is working closely with the banks and operators behind the country's two m-banking schemes. That way the regulator can see what is going on, so the schemes' operators get more flexibility. The experience will feed into new banking regulations. Rules that are too tight will hinder adoption; rules that are too lax could allow fraudsters to bring the whole idea of branchless banking into disrepute. But if regulators strike the right balance, m-banking may provide the next example of the mobile phone's transformational power.

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On English representation, business and human rights, technology clusters, America's military, malaria drugs, Cornish

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From The Economist print edition

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The West Lothian question

SIR – I am surprised that *The Economist* has misinterpreted my proposal for an English Grand Committee ("Tax and mend", November 3rd). An English Grand Committee would not leave Scottish members of Parliament with "little to do" since the majority of House of Commons business, including tax, public expenditure, immigration, defence, foreign policy and a host of other issues, is not devolved. In the recent Queen's Speech, 18 out of the 29 bills mentioned will apply to the whole of the United Kingdom.

The reforms that you suggest—adjusting the Barnett spending formula and devolving power to English regions—would do nothing to tackle the unfairness of England being the only part of the United Kingdom that does not have the last word on its own affairs. The Barnett formula is a question of public expenditure, not lawmaking. Similarly, regional assemblies, besides being unpopular, would not have legislative power and would not solve the problem either.

I am a Unionist and would not accept two classes of MP. But we have that at the moment, with English MPs at a disadvantage compared with Scots, Welsh and Northern Irish. An English Grand Committee would make the relationship between MPs more equal. This government introduced devolution to Scotland, Wales and Northern Ireland. Now it must live with the consequences as regards England.

Sir Malcolm Rifkind MP
House of Commons
London

Supporting human rights

SIR – Your article on business and human rights sees a "storm" where in fact there is healthy and productive intellectual debate ("Doing the wrong thing", October 27th). The letter to which you refer recently sent from NGOs to John Ruggie reaffirms strong support for the work of Mr Ruggie's mandate as United Nations special representative on business and human rights. While there are multiple views on short-term priorities, broad agreement exists around the objective of improving the human-rights performance of companies.

A number of consultations are being organised to support Mr Ruggie in this phase of his work with the co-operation of organisations like Global Witness, the Clean Clothes Campaign, Oxfam, the Danish chapter of the International Commission of Jurists and the organisation I lead (Realising Rights: The Ethical Globalisation Initiative). Some activists want the mandate to go further, but there is no question that serious efforts are being made to build a stronger international human-rights regime that governs the activities of all participants, including corporations.

Mary Robinson
President
Realising Rights
New York

Business and innovation

SIR – I do not agree with your assertion that technology clusters have a "fading lustre" (A special report on innovation, October 13th). The concept of clusters is now well understood and empirical work on their

incidence and impact is growing rapidly. But there is still confusion about the policy implications. Should clusters be allowed to form spontaneously, which is what has usually occurred, or should there be some sort of policy intervention?

Cluster-policy thinking is very different from “industrial-policy” thinking, though many economists lump the two together. Cluster theory is neutral, rather than about picking winners, intervention, protection and subsidies. Clusters are good in any field because they boost productivity and innovation, and cluster policy seeks to reduce constraints and encourage externalities to raise the productivity of competition.

There is limited experience in policy toward clusters, which sit in between policies aimed at the general business environment and policies targeted at creating incentives for individual firms. There are literally hundreds of cluster initiatives all over the world today that are pursuing varying approaches to public-private collaboration to improve the business environment. While some of these initiatives will have limited impact, and a few may do harm, as in the biotech examples you mentioned, there are strong reasons to believe the cluster/region level will be a growing focus of economic policy.

Michael Porter
Professor
Harvard Business School
Boston

Military intelligence

SIR – When unleashing their military might, few leaders are aware of the political dimensions and of the powerful social forces that are being unleashed (“Brains, not bullets”, October 27th). In the book “The Eagle's Talons: The American Experience at War”, Dennis Drew and Donald Snow note that there are two dimensions to victory: defeating both hostile ability and hostile will. In Iraq and Afghanistan, America has substantially defeated the enemies' hostile ability, but only belated efforts have been made to include diplomats and civilian agencies in defeating hostile will. Only when a political solution has been achieved will the insurgents lay down their arms and stop resisting.

Scott Rogers
Colorado Springs, Colorado

SIR – I suspect you may be correct in your assessment of America's need for military forces tailored for counter-insurgency operations. However, the “big boys” have an inordinate fondness for “big toys” and so will continue to spend large sums on large weapons systems. There is much less glory available for successfully fighting with a couple of companies of special forces, compared with a really rockin' stompin' win from an aircraft-carrier with a couple of corps of armour.

Paul R. Wisgerhof
Fairfax, Virginia

Good intentions

SIR – You fail to properly discuss malaria drug quality (“Money v mosquito”, November 3rd). Substandard drugs (as opposed to outright fakes) contain some active ingredient, making them likelier to pass basic pharmacological tests. But while fakes might kill individuals, substandard drugs can drive parasite resistance and could doom a whole class of drugs, as well as not cure the patient. A subsidy is welcome, but will increase incentives for manufacturers of substandard and fake drugs alike. Strengthening regulatory controls in developing countries is vital. Before launching a full-scale subsidy, pilot programmes to test the market, such as that being run in Tanzania by the Clinton Foundation, should be closely analysed first.

Richard Tren
Director
Africa Fighting Malaria
Washington, DC

Wise words

SIR – Reviving a dead language “the most useless activity for humanity to engage in” (Letters, November

3rd)? What about train-spotting, birdwatching and stamp-collecting, to name but three? Our humanity is most clearly defined by the diversity of tributaries down which we paddle to seek knowledge. Up with the Cornish, I say.

Peter Johns
Alderley Edge, Cheshire

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Global warming

Getting the message, at last

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Illustration by Claudio Munoz

Congress is now taking climate change fairly seriously

TO SEE how the mood in Congress is changing on global warming, look no further than America's Climate Security Act (ACSA). This is a bill that seeks to limit and ultimately slash America's emissions of greenhouse gases. For one thing, it is sponsored by John Warner, a Republican who once opposed all such measures. For another, it has won the support of Max Baucus, a senator from Montana, whose coal-mining constituents hate the idea. It has already cleared more legislative hurdles than any of the many previous bills on global warming.

So will a law pass soon? Probably not; the Senate and the House of Representatives are already struggling to reconcile rival bills on energy, and will doubtless find global warming even tougher. The House is not yet properly up to speed on the subject, and in the Senate a global-warming sceptic has vowed to filibuster any bill that places firm limits on America's emissions—a tactic that can only be overcome with 60 of the chamber's 100 votes. Even then, George Bush, another critic of caps, would probably veto such a bill. Nonetheless, the current debate provides a good indication of the sort of horse-trading that will be needed to push a bill through in future.

Past bills have foundered either because they seemed too ambitious to Republicans worried about the effects of a cap on American industry, or too feeble to environmentally-minded Democrats. But Mr Warner and the bill's co-author, Joe Lieberman, an estranged Democrat, have included something for almost everyone. To please the greens they have proposed severe cuts in America's emissions, of about 60% by 2050. To please the business lobby, they have proposed measures to reduce the costs of compliance. To please everybody, they have included the magic word “security” in the bill's title: keeping America safe from dangerous weather.

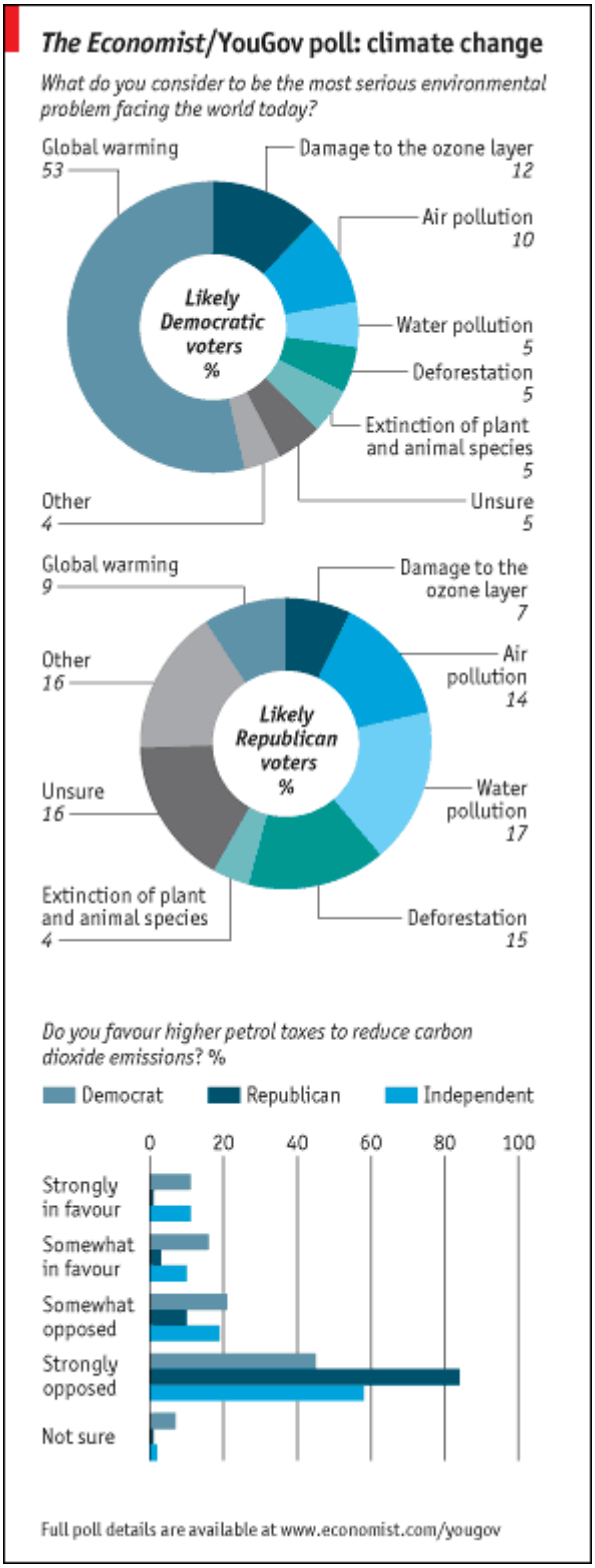
Like most other bills on climate change, ACSA involves a cap-and-trade scheme: the government sets an overall limit on emissions and then sells or gives away an equivalent number of tradeable permits to pollute. This allows the firms that find it cheapest to reduce their emissions to do so, leaving those for which cuts would be costlier to buy permits. All the leading Democratic candidates for president, along with John McCain on the Republican side, have endorsed this concept.

Supporters of a tax on emissions, an alternative to cap-and-trade advocated by many economists, are

few and far between. Michael Bloomberg, the mayor of New York, who is rumoured to be considering an independent run for president, supports one, as does John Dingell, a prominent congressman. But most politicians are certain that no policy involving the word “tax” will prosper.

The details of the different cap-and-trade schemes vary wildly. Some involve giving most of the permits away to businesses—a notion that green groups denounce as corporate welfare. By contrast, in the Regional Greenhouse Gas Initiative, a scheme that will soon get underway in the north-east (see article), all the permits will be auctioned. Hillary Clinton, for one, wants any federal scheme to take the same approach. ACSA aims for the middle ground by proposing that the proportion of permits sold at auction should rise gradually, from 24% in 2012 to 73% in 2036.

How should the revenue from such auctions be spent? Most bills envisage compensation of some sort for dirty industries, which would suffer most from an emissions cap. Friends of the Earth estimates that ACSA would dole out $324 billion to the coal industry, for example, in addition to awarding it free permits worth hundreds of billions of dollars more. Beyond that, most congressmen want to funnel any spare cash to pet causes: renewable energy, biofuels and perhaps even nuclear plants, even though they produce no emissions and so should prosper under a cap. Mrs Clinton wants both to cut taxes and to help poor families cope with the higher fuel and power costs that an emissions cap would bring.



Some senators worry that the costs of a cap-and-trade scheme may spiral out of control. They suggest that the government should cap the price of permits by agreeing to sell more of them at a fixed rate if they get too expensive. That, in turn, has angered the green lobby, who say that it is the bill's environmental benefits, rather than corporate profits, that should be sacrosanct. ACSA attempts to square this circle by setting up a sort of central bank of carbon, which would allow firms to borrow permits against their future allocations. That might help to smooth out spikes in the carbon price, without lifting the overall cap. The bill also allows firms to pay for “offset” schemes to reduce emissions in industries that do not have a cap, such as agriculture and forestry, in lieu of making cuts of their own.

ACSA's biggest concession to industry, however, is a clause that would penalise imports from countries that do not have an emissions cap. To get such goods through customs, importers would have to buy permits to cover the greenhouse gases emitted during their manufacture. One of the biggest fans of this idea is the AFL-CIO, America's trade union federation, which worries that a cap-and-trade scheme would further sap the competitiveness of American manufacturing and hasten the exodus of jobs to China, India and Mexico.

Yet, for all these sops to business, ACSA would still dramatically reduce emissions—although not by quite as much as most scientists think is warranted, according to the World Resources Institute, a think-tank. It would cover roughly 80% of the economy. To secure the support of one of the greener senators, Messrs Lieberman and Warner actually expanded its scope to include household consumption of natural gas, which they had planned to exempt. They also lowered the caps for the early years of the scheme, to make sure that its impact would be swift. And the bill provides for periodic reviews of the cap, in case it proves too generous.

Many of these ideas are copied from earlier bills. Indeed, ACSA is something of a synthesis of the most popular elements of its rivals. This might help it secure the support of the congressmen whose ideas it borrows. And even if that does not guarantee its passage, the next Congress and president are likely to use the bill as a starting point for further negotiations.

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Cap-and-trade in the north-east

Embracing Reggie

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A scheme that tries to avoid Europe's mistakes

COULD America's first experiment with a cap-and-trade scheme for greenhouse gases go awry? That is the fear of some observers of the Regional Greenhouse Gas Initiative (RGGI), an agreement among ten north-eastern states to cut emissions from power plants by 10% between 2009 and 2018.

The states in question formed RGGI (pronounced “Reggie”) out of despair at the federal government's failure to tackle emissions growth. Some states in the West and the Midwest are working on similar schemes. But RGGI will be the first to start up: emissions will be capped from January 1st 2009.

RGGI's designers hope to avoid some of the flaws that have dogged the Emissions Trading Scheme (ETS), the European Union's ongoing experiment with cap-and-trade. European governments handed out emissions permits to existing power plants and factories free of charge; that turned out to be a windfall for big polluters, who were able to sell on unneeded permits for huge profits. Moreover, it gradually became clear that governments had handed out too many permits, causing their price to fall to almost nothing in the first phase of the scheme, which ends this year. If permits are so cheap, why cut emissions?

Under RGGI, by contrast, state governments will auction almost all permits. But Véronique Bugnion of Point Carbon, an energy consultancy, suspects that—at the start of the scheme, at least—there may be more permits on offer than utilities need, thanks to a recent contraction in the RGGI states' emissions. During the early years of the decade, when RGGI's emissions cap was being set, the price of oil was relatively low. It has since risen sharply, not only in absolute terms but also relative to natural gas. That has led utilities to use more gas and less oil for power generation in the RGGI states; and since gas-fired generation produces fewer emissions than the oil-fired sort, overall emissions from the RGGI states have fallen too.

RGGI's permits, unlike those of the ETS, are valid for the lifetime of the scheme. So firms will have an incentive to buy up any excess during the early years for use later on, when the cap begins to fall. That might help to prevent an embarrassing price crash like Europe's. RGGI states are also considering setting a reserve when they auction permits.

But even if these measures succeed, it remains true that RGGI covers a relatively small area in which unusual weather, the refurbishment of a few big power stations or the opening of a new transmission line for imported power could move the whole market. The correct response to any teething pains RGGI may suffer, its defenders say, is not to curb the scheme but to expand it.

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Guantánamo

Bay watch

Nov 15th 2007 | GUANTÁNAMO BAY AND WASHINGTON, DC
From The Economist print edition

The closure of America's most notorious prison may be only a matter of time

IT WAS a lovely day in America's most famous offshore outpost. After the recent tropical storms the usually parched earth, dotted with tall cacti, had turned a brilliant green. The hot sun shone, the sea sparkled, the palm trees waved gently in the breeze, and the occasional giant iguana, protected in this part of Cuba, lumbered by. Vice-president Dick Cheney could almost be forgiven for suggesting that Guantánamo Bay is more like a holiday camp than a penal institution.

The suspected terrorists held here, on 45 square miles (116 sq km) of territory leased “in perpetuity” from Cuba since 1903, were being “very well treated”, Mr Cheney insisted two years ago. “They're living in the tropics. They're well fed. They've got everything they could possibly want.” Donald Rumsfeld, the former defence secretary, could not have agreed more. The detainees were being looked after “with the appropriate care and, yes, compassion,” he said in February 2004—the same month that the International Committee of the Red Cross (ICRC) was decrying the “harsh treatment, sometimes tantamount to torture” found at the camp.

Guantánamo has become a byword for all that is wrong with America. But things have changed. The infamous Camp X-Ray, where shackled, often blindfolded men were held in wire cages protected only by a flat roof, has long since been abandoned. All the detainees are now housed in air-conditioned metal and cement blocks, most in single cells with their own basin and flushing lavatory. Each is given a copy of the Koran and is allowed to pray five times a day, led by an “imam” elected by the detainees themselves. Ample halal meals are provided three times a day with the result, as the Joint Task Force (JTF) responsible for the camp likes to boast, that many detainees have put on weight. Two hours' exercise a day is also allowed.

“Compliant” detainees—those who obey the camp rules—are housed in Camp 4, where they enjoy special privileges, including the right to mingle together and exercise for 12 hours a day. They have access to a library of more than 5,000 books in 19 different languages; can watch videos and play sports such as volley-ball, pingpong and football; and can even get extra loo paper, on request. Unlike their more unruly colleagues, they are also provided with a mattress, sheets, a prayer rug, earplugs and underwear. Most detainees now have access to a lawyer.

Indeed, a checklist drawn up by the JTF, comparing a prisoner-of-war's 25 basic rights under the Geneva Conventions with those of an alleged “enemy combatant” in Guantánamo, finds few big differences. The Guantánamo detainees generally have less freedom of movement, have all their correspondence screened, are not allowed to keep any personal belongings and, if charged, will be tried before a special military commission rather than a regular court-martial. But unlike ordinary POWs, many are released before the end of hostilities; well over half Guantánamo's 778 detainees have already returned home. Furthermore, although the detainees may be asked any question, they “aren't required to answer”, the JTF insists. Nor are they penalised for staying silent. If true, this is change indeed.

After a visit in April, Jacob Kellenberger, the ICRC's president, praised the “considerable improvements” at the camp. Guantánamo was no longer what it was in 2002-03, he said. These days, the hordes of journalists and NGOs flown down to the camp by the Pentagon tend to focus more on the failings of the legal proceedings for the 80 or so detainees who may one day be tried for war crimes, rather than on their physical conditions. Six years since the creation of the military commissions was first announced, only one detainee, David Hicks, an Australian, has been convicted (after a plea-bargain); and only one other, Omar Khadr, a Canadian, has been formally arraigned in court—last week. It could be months before his trial begins.

By then, neither the detention camp nor the military commissions may exist. For the past 18 months American officials, including President George Bush himself, have been saying they want to close the camp. Hot air, perhaps; but the Supreme Court's surprise decision in June to hear a detainee *habeas*

corpus petition, after refusing two similar requests two months before, has given the search for an alternative a sense of urgency. A reversal of this sort is very rare and, as it requires the approval of five of the nine justices, many are predicting that the court may come out in favour of the detainees. Oral arguments are scheduled for December 5th, with a ruling expected by the end of June.

Giving detainees the right to challenge their indefinite detention in America's civilian courts would rob Guantánamo's detention camp of its *raison d'être*. It was precisely because this patch of leased Cuban land was believed to be beyond the reach of both domestic and international law that it was chosen to hold “enemy combatants”—ie, belligerents not eligible for prisoner-of-war status—without human rights or legal protections. A ruling in their favour could also lead to men who may be highly dangerous terrorists being released on to American soil for want of sufficient evidence to convict them in the courts.

Hence the scramble to come up with an alternative plan. It should be easier now that many of the pro-Guantánamo old guard—Donald Rumsfeld, John Ashcroft, Alberto Gonzales and the like—have gone. Robert Gates, the defence secretary, has already asked his officials to draw up concrete proposals for the camp's closure. Michael Mukasey, sworn in this week as attorney-general, has said that he wants the camp closed “because it's hurting us”. He has promised to undertake a review of Justice Department legal opinions on the administration's detention powers.

The long-running battle over Guantánamo between the “moderates” in the State Department and among the army's top brass, on the one hand, and the Justice Department and the civilians in the Pentagon, on the other, is not yet over. Mr Cheney, in particular, is fighting a fierce rearguard action. But the moderates feel they at last have the wind in their sails—and, possibly, a solution.

Of the remaining 300-odd detainees in Guantánamo, they suggest, a further 100 or so of the least dangerous should be returned to their home countries, if they will take them. The rest should be transferred to military prisons in America under a new “preventive” detention scheme for suspected terrorists. At the same time, special federal courts, with strict rules to protect classified information, would be set up to hear detainee challenges to their detention. Congressmen may well dislike such a plan. But a Supreme Court ruling may help them change their minds.

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The campaign trail

Primary colour

Nov 15th 2007
From The Economist print edition

Big Love
"I love my wife and my five sons and their five wives. Wait a second. Let me clarify that. They each have one."

Mitt Romney campaigning in New Hampshire, ABCNews.com, November 10th

Tell me what you want
"All I can tell you is I'm a free-trader, so I'm not your candidate. I'm sorry, but I'm not."

John McCain fails to pander to the masses. Boston Globe, *November 9th*

Rocketman
"Sometimes Americans who are here too long tend to become cynical about the American dream. New people coming in have this wonderful belief that they or their children can go to the moon."

Illustration by Kevin Kallaugher

Rudy Giuliani supports immigration. Las Vegas Review-Journal, *November 9th*

Wishful thinking
"My understanding is that President Clinton is not on the ballot."

Barack Obama, ABCNews.com, November 8th

Phone home
According to the latest Quinnipiac University poll, 70% of Connecticut voters would like Chris Dodd to drop out of the presidential race and return to his real job representing the state in the Senate.

Very sporting
"I've always said, as a hunter, you never put the cross-hairs on a dead carcass. You only aim for something that's alive that you'd like to take home."

Mike Huckabee explains why other candidates have started attacking him. New York Times, *November 9th*

This will only hurt a little
"No one wants to be in a position to penalise anyone, but our rules are self-enforcing. They give me no options."

Mike Duncan, Republican chairman, announces that five states will lose half their delegates to the party convention because they are holding primaries before February 5th. Associated Press, November 8th

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The Bernard Kerik case

Too close for comfort

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From The Economist print edition

An indictment raises questions about Rudy Giuliani's judgment

HIS mother, a prostitute, abandoned him when he was small. Her probable pimp later killed her. But Bernard Kerik overcame his awful start in life. After army service and a spell as a security officer in a Saudi royal hospital, he eventually became an undercover narcotics detective and chauffeur to Rudy Giuliani, then mayor of New York. In 2000 he was made the city's police commissioner; later, he was nominated to head the federal Department of Homeland Security. Now his even more rapid fall is threatening Mr Giuliani, his one-time mentor and friend and the Republican presidential front-runner.

Three years ago, shortly after he was nominated for the Homeland Security job, Mr Kerik withdrew his name because of tax difficulties involving his former nanny. This turned out to be the least of his problems. He had abandoned a Korean daughter; he had accepted gifts from firms doing business with New York City, and failed to report them; and he had commissioned busts of his moustachioed self. Not to mention tales of a secret wife, mistresses and Mafia ties.

Last week, after an 18-month-long federal investigation, the bulldog-faced ex-cop was indicted on 16 counts of conspiracy, tax fraud and making false statements. According to the 29-page indictment, Mr Kerik complained that his civil servant's salary was inadequate and he “felt like he was on welfare”. He is accused of accepting and hiding hundreds of thousands of dollars he received while serving as head of New York's Department of Corrections, as police commissioner and later as one of Mr Giuliani's business partners. The indictment also accuses Mr Kerik of working to get city contracts for a Mafia-connected company in exchange for a $255,000 apartment renovation, with Jacuzzi and marble rotunda, and of filing false statements to the White House during his Homeland Security vetting.

Mr Kerik was released on $500,000 bail and faces, if convicted of all the charges, a possible maximum sentence of 142 years in prison and $4.8m in fines. But it is Mr Giuliani who faces the political fallout. It's unclear how much he knew about Mr Kerik's dodgy deals, but his fellow Republican presidential candidates are sure to ask, if only to dent his double-digit lead in the polls. John McCain used the indictment to question Mr Giuliani's judgment. He pointed out that Mr Giuliani ignored Mr Kerik's disastrous stint in Iraq, where he failed in 2003 to train the Iraqi police force properly.

For his part, Mr Giuliani regrets not vetting him better and has apologised to Mr Bush for recommending him. But he has continued to call Mr Kerik a hero, who cut shootings by 74% and overall crime by 60% when he was police commissioner.

Mr Kerik is being tried in the district where Mr Giuliani first made his name as a federal prosecutor, busting corrupt public officials and mafiosi. But perhaps the cruellest cut is that his next court hearing is scheduled for January 16th, not long before the big bunch of primary elections on February 5th. The trial's calendar will probably shadow the campaign.

Mr Giuliani will also be watching another court case. Judith Regan, Mr Kerik's former publisher and paramour, filed a $100m lawsuit on November 13th against her former bosses at News Corp, claiming they had asked her to lie to federal investigators to protect Mr Giuliani.

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Maryland

Fresh odds

Nov 15th 2007 | CHARLES TOWN, WEST VIRGINIA
From The Economist print edition

The state legislature considers legalising slot machines, again

AP

Trots for slots

JUST across the idyllic upper Potomac river in the West Virginia panhandle, a drenched racetrack sits empty in a mid-Atlantic downpour. Even so, out-of-state visitors fill the racetrack's towering car park, each trying his luck at a sport slightly less patronised by kings: slot-machine gambling.

For years, West Virginia has enticed Marylanders and Virginians across the border to feed cash into spin-reeled gaming machines, and for at least as many years Maryland lawmakers have battled over whether to allow slot gambling on their own soil. But now the politicians favouring slots seem closer than ever to winning. “The devil is at the door,” announced the state's comptroller, Peter Franchot, last month. But, he added, boldly mixing his metaphors, “We're going to put the stake through the vampire's heart.”

Mr Franchot says that gambling's social damage outweighs the money it might bring in. Casinos replace other places of entertainment near them without necessarily replacing jobs, since automated machines do not require much human upkeep. Gambling houses can bring crime—and addiction. “Gamble Too Much?” ask the flyers scattered round the slots hall in Charles Town. Programmes to treat gambling addicts are another cost that Maryland would have to pay if it were to let the slots in.

A 1999 congressional study on gambling concluded that “destination” casinos, which attract many out-of-state visitors, can bring money and jobs to a local economy. West Virginia, a notably poor state, gets 12% of its revenue from gambling taxes. But Delaware, Pennsylvania and West Virginia, Maryland's neighbours, all now allow gambling in certain areas, minimising the benefits of legalisation in Maryland. Some West Virginian politicians are also threatening to allow card and dice-table gaming near the Maryland border.

Nevertheless Maryland's new governor, Martin O'Malley, estimates that by 2012 the state could raise $550m a year by authorising 15,000 racetrack slots. This could help fill a big hole predicted in the budget. In addition, proponents say, it would help save the state's historic but run-down racing industry.

Marylanders also favour installing slots. A *Washington Post* poll on October 24th found that 68% of residents approved of Mr O'Malley's slots plan. In the car park at the Charles Town Races and Slots, Marylander Cindy Hartman says she would gamble in Maryland if she had the chance, even though she usually loses money.

With the adamant backing of the wheeler-dealer president of Maryland's Senate, the state legislature now seems to be close to authorising a referendum on the issue in the special session that convened on October 29th. And with so many hopeful punters like Ms Hartman in the state, Maryland's voters seem likely to give the plan their approval.

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Health care

On the frontier

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Changes for America's rural hospitals

COOK hospital is not exactly a bustling medical complex. It has 14 beds and three full-time doctors. Its service area includes the town of Cook, population 622, and some 2,500 square miles (6,500 sq km) of northern Minnesota. Some patients have travelled to the hospital by snowmobile, dogsled and canoe, says Al Vogt, Cook's administrator. But Cook, remote as it may be, is doing its best to be an exemplar of the modern rural hospital.

Rural hospitals face stiff challenges. A greater share of their patients are enrolled in Medicare, the federal health plan for the elderly—17.4% in 2003, compared with 13.1% in city hospitals. They have little extra cash to spend on new equipment and training, let alone on specialists. It is hard enough to lure primary-care doctors to remote towns. (For Cook, a main attraction is a footpath called the Orr Bog Walk, 17 miles away.) It is impossible and unnecessary to have a hospital in every village. But an efficient rural hospital plays an important role, argues Terry Hill of the Rural Health Resource Centre. Emergency rooms increase survival rates. Easily accessible, preventive care saves money for everyone in the long term.

Faced with declining revenues, hundreds of rural hospitals closed in the 1980s and 1990s. Then in 1997 Congress created the rural hospital flexibility (Flex) programme. This allows a small rural facility to receive cost-based reimbursements from Medicare, provided it is designated a Critical Access Hospital (CAH). It must have no more than 25 beds, keep patients for an average of 96 hours or fewer and be the only hospital within 35 miles, or 15 in the mountains. The programme almost expanded too far: until 2006 states could waive the distance requirement for “necessary providers”. But now the number of CAHs is stabilising, at nearly 1,300.

They are by no means swimming in cash. In a recent sample of CAHs the median operating loss for treating patients was almost 4%, according to researchers at the University of North Carolina. If they want to stay open, they will have to create economies of scale.

One way is to invest in health-information technology, which can help a rural hospital tap the resources of larger facilities. Some 80% of them use teleradiology and 24% telepharmacy, according to a survey by professors monitoring the Flex programme. Cook, which became a CAH in 2000, sends digital X-rays to radiologists as far away as Australia. The hospital also links up by video to psychologists in Duluth and dermatologists and endocrinologists in Minneapolis, saving time and money for doctors and patients alike.

There is room for further investment. Despite a mandate from the White House that most Americans must have electronic health records by 2014 (and a flurry of accompanying federal grants), money for health IT is scarce. Installing it is expensive; then employees must be trained to use it, and the system must be maintained in the long term. Working together may be the answer. Cook has reduced the costs of investing in IT by joining a small co-operative.

Another model of collaboration is Avera Health, based in Sioux Falls, South Dakota. Since its founding almost a decade ago, Avera's network has grown to span South Dakota, Minnesota, Iowa, North Dakota and Nebraska. Avera offers varying levels of support to hospitals, clinics and nursing homes—either by owning them outright, leasing them or providing financial management, health IT or medical training for a fee. Increasingly, the rural hospitals that survive will be those that are remote, but not isolated.

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Lexington

With us or against us

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Illustration by Kevin Kallaugher

America's excessive partisanship is dangerous both at home and abroad

FRANK RICH, of the *New York Times*, accuses the Bush administration of conducting a "quiet coup, ultimately more insidious than a blatant putsch like General Musharraf's". Ann Coulter, of here, there and everywhere, says the Democratic Party is so dumb that "it's as if all the brain-damaged people in America got together and formed a voting block". And every day thousands of would-be Riches and Coulters inject similar sentiments into the blogosphere.

This sort of partisan rhetoric is tedious. But hasn't American politics always been full of it? In the 1828 election Andrew Jackson's supporters accused John Quincy Adams of being a drunken fornicator who sold virgins into white slavery, while Adams's supporters accused Jackson of committing 18 murders. And isn't partisanship exactly what strong democracy is about?

The argument over the merits of partisanship has itself led to furious divisions. Partisans welcome it, while moderates deplore it. But the past few years have produced a body of scholarly literature that raises the discussion to a more elevated level. And now Ronald Brownstein, one of America's best political journalists, has produced a sparkling new book on the subject, "The Second Civil War: How Extreme Partisanship Has Paralysed Washington and Polarised America".

This pile of literature points to two conclusions. The first is that partisanship has produced plenty of benefits. It offers voters "a choice, not an echo", and stimulates interest in politics. The 2004 election produced a turnout of 61%—huge by American standards, and more than six percentage points higher than in the 2000 election. But the second conclusion is that partisanship has gone too far. America is more divided than it has been for 40 years, and concomitant divisiveness is hampering its ability to deal with pressing problems both at home and abroad.

Richard Hofstadter, one of America's greatest political historians, once observed that each party was a hotch-potch of conflicting interests, and that the parties' main business was to seek compromise. That is no longer the case. George Bush has happily governed as "president of half the country" (the partisan gap in his approval rating has reached an astonishing 70%). Congress has started to act like a parliament. Voting along partisan lines in Mr Bush's first term ran at 90% among House Republicans and 89% among Senate Republicans (the figures for Democrats were 86% and 85% respectively). And Americans have taken to living in political ghettoes. In 1976, when Jimmy Carter beat Gerald Ford by two percentage points, only 27% of Americans lived in "landslide counties", where one candidate won by 20 points or more. In 2004, when Mr Bush beat John Kerry by a similar margin, 48% of Americans lived in

such places.

This partisan revolution is largely the result of what Mr Brownstein calls “the great sorting out”. White southerners have changed their party affiliation from Democratic to Republican. And ideologues of the left and right have divided themselves along party lines. But the “sorting out” has been reinforced by political tinkering. Gerrymandering means that a growing number of politicians represent super-majorities. And the primary-election system means that they have every incentive to appeal to the most partisan people in their districts.

In his farewell address in 1796, George Washington took aim at the dangers of “faction”—arguing that it distracts attention from important questions, weakens the government and “agitates the community with ill-founded jealousies and false alarms”. But if anything this understates the dangers of today's hyper-polarisation. Partisanship has embittered the 49% of the electorate who voted against Mr Bush. It has alienated the 45% of voters who described themselves as “moderate”. It has weakened the checks and balances built into Congress (the Senate, supposedly the more deliberative chamber, has not yet even got around to debating Mr Bush's “surge” in Iraq). And it has made it impossible to deal with long-term problems, such as the budget deficit and Social Security reform, which require mutual sacrifices and complex deal-making.

This is particularly dangerous when it comes to foreign policy. The explosive divisions over the Iraq war have weakened Mr Bush, who might have corrected his strategy earlier if he had faced serious scrutiny from Congress. And they have certainly weakened America abroad. They not only signal to America's enemies that the country is divided, but also suggest that policy might change dramatically with a new president. Hyper-power and hyper-partisanship make bad bedfellows.

Sinking fires

Is there any chance that the trend can be reversed? Scholars such as Bill Galston of the Brookings Institution have suggested various institutional reforms, from the far-fetched (reintroducing multi-member districts) to the sensible (taking redistricting out of the hands of party hacks). But there are signs, as Mr Brownstein argues, that the system is beginning to fix itself.

In his second term Mr Bush learned that partisanship is a dangerous weapon—powerful when things are going well, but self-destructive when things turn against you. His bid to reform Social Security turned into a flop because the Democrats believed they had nothing to gain from co-operation.

For their part the resurgent Democrats are likely to be less partisan than the Republicans. The Democratic coalition is much less homogeneous than the Republican one. Only 52% of Democratic voters describe themselves as liberals, compared with the 77% of Republican voters who call themselves conservatives. The partisan fires stoked high for the past 40 years are not going to gutter out; the two leading candidates on both sides, Rudy Giuliani and Hillary Clinton, are notably polarising figures. But they may burn less fiercely than they did under Mr Bush.

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Brazil

All this and oil too

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From The Economist print edition

Illustration by Claudio Munoz

God may indeed be Brazilian after all

Get article background

WHEN Francisco Suares, a Portuguese explorer, wrote home to his brother in Lisbon about Brazil's natural bounty in 1596, he declared himself “ashamed to write it, fearing that I shall not be believed.” And so it remains today. Brazil's forests are bigger than anywhere else's. Its soil is so fertile that some trees grow to full maturity quicker than people do. Beneath the soil lie huge mineral deposits that are raw material for China's double-digit growth. Brazil is already on its way to becoming an alternative-energy superpower. And as if to prove a popular saying that “God is Brazilian”, it now seems that there are billions more barrels of oil than previously thought lying beneath deep waters off the country's coastline.

Just how many billions is unclear, but Petrobras, Brazil's state-controlled oil company, announced earlier this month that it reckons the Tupi oilfield contains between 5 billion and 8 billion barrels. That may not quite yet put Brazil in the same league as Venezuela and Saudi Arabia, as Dilma Rousseff, President Luiz Inácio Lula da Silva's chief of staff who also chairs Petrobras's board, excitedly proclaimed. But the higher estimate would make the Tupi field alone equal to all of Norway's reserves. It contains light crude, which is less expensive to refine and therefore worth more. And there may be other big deposits to be found nearby.

José Sergio Gabrielli, Petrobras's chief executive, refuses to speculate about how big an oil power Brazil might become. But he does concede that there is the potential for many more discoveries on the scale of Tupi—which itself is the world's second-biggest strike in 20 years, after Kazakhstan's 12 billion-barrel Kashagan field, discovered in 2000.

Most of Brazil's oil comes from the Campos basin, in the waters off Rio de Janeiro. It is typically found at depths of 1,000-2,000 metres below the seabed. Below that lies a huge layer of salt, at some points more than a mile thick. This stretches both north and south to the hitherto less prolific basins of Espirito Santo and Santos. It is below the salt, in the Santos basin, that Petrobras discovered Tupi. The company has also found “sub-salt” oil in Espirito Santo, although it has not yet assessed the scale of this. Mr Gabrielli believes that the two basins have yielded relatively little oil to date not because it is not there, but because it lies deeper underground, below the salt.

Tupi's oil will be hard to extract. Petrobras is a world leader in deep-water oil production, but Tupi is farther down than any of its existing fields. Drilling through the salt layer and the hard rock beneath brings further technical difficulties. The first test-well alone cost $240m. Moreover, there is a shortage of skilled labour and equipment throughout the oil industry at the moment—although Mr Gabrielli says Petrobras can transfer staff and resources from other projects if necessary.

Despite these caveats, it is reasonable to assume that Brazil's economy and currency will get a boost when the oil starts flowing, it is hoped, in 2010. The discovery might also tip the balance of power in South America further in Brazil's favour. Already self-sufficient in oil, Brazil is now likely to become a significant exporter. That may reduce the clout of Venezuela's oil-rich president, Hugo Chávez, in the region. As if to underline this, Petrobras announced on November 13th that it was pulling out of a joint venture in Venezuela.

Brazil's drive towards oil self-sufficiency follows the opening up of the industry to foreign investment in the 1990s, when the government also floated some 40% of Petrobras's shares on the stockmarket. Britain's BG Group has a 25% stake in the Tupi field, and Portugal's Galp Energia holds 10%.

The government followed up the announcement of the Tupi field by withdrawing neighbouring blocks from an auction of exploration rights due later this month. That might signal rising petro-nationalism. But it also looked prudent, since those blocks may be worth much more as more becomes known about Tupi.

Amid the euphoria, which included an instant leap of 26% in Petrobras's share price, came suspicion about the timing of the announcement. Less than a week after it was made, the company announced a poor set of results, with operating profit down 22% compared with the same quarter last year.

Petrobras has also faced mounting difficulties in supplying natural gas to thermal power plants, especially since its fields in Bolivia were quasi-nationalised last year. Some see the Tupi announcement as an attempt to distract attention from this. “It is like throwing a second ball onto a football pitch when the game is going against you,” says Alexandre Marinis of Mosaico, a political consultancy.

Electricity rationing under the previous government in 2001-2 helped Lula to win office. One solution now would be to raise the price of gas, but officials are worried that this would feed into inflation, and jeopardise the scope for further cuts in interest rates. Mario Pereira, an energy consultant, reckons that the risk of electricity shortages should wane after 2008, if Petrobras completes a planned liquefied natural-gas terminal on time.

That may be a big if. Lula and Ms Rousseff, a former Trotskyist who is sometimes touted as a potential presidential candidate for the ruling Workers' Party, were keen to associate the government with Petrobras's strike. But the oil may not start flowing until after the next presidential election in 2010. Energy may be an electoral headache rather than a boon for the government, if not for the country.

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The Ibero-American Summit

The king was not amused

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An undiplomatic row highlights a lack of consensus

IT IS a routine. Every time that Latin American leaders get together at a regional summit, the headlines are stolen by Venezuela's outspoken leftist leader, Hugo Chávez. But at the Ibero-American summit in Chile's capital, Santiago, Mr Chávez got some help from an unusual quarter, Spain's King Juan Carlos.

AFP

Shut up, said Juan Carlos to Hugo Chávez. Fat chance

At the summit's televised closing session on November 10th, Mr Chávez launched a seemingly pre-meditated attack on José María Aznar, Spain's former prime minister, whom he called a “fascist”. When Mr Aznar's socialist successor, José Luis Rodríguez Zapatero, demanded respect for an elected leader, Mr Chávez sniped in the background, prompting a clearly infuriated King Juan Carlos to interject, “Why don't you just shut up?”

That scene, replayed on YouTube, brought delight to countless thousands who have suffered Mr Chávez's chronic verbal diarrhoea. The king later walked out when Nicaragua's president, Daniel Ortega, joined Mr Chávez in attacking privatisation and Spanish businesses.

Spanish officials were keen to prevent the incident from triggering a full-scale diplomatic row. Not so Mr Chávez, who thrives on public verbal spats. This week he stepped up his criticism of Mr Zapatero. He may reckon that this will help to turn a referendum on unpopular constitutional changes into a vote for or against him (see article). But he may have picked the wrong target. Spain and its monarch, if not all of its companies, are popular in Latin America.

The theme of the summit was “social cohesion”—the need for Latin America to use commodity-fuelled economic growth to achieve equality of opportunity. But once again, the divisions among the region's left-of-centre governments were on display. One bitter dispute involves Argentina's environmental objections to a big new paper mill on Uruguay's bank of the river that divides them. The mill started operating during the summit, prompting an Argentine diplomatic protest.

Mr Chávez and Mr Ortega, along with Bolivia's Evo Morales and Cuba's vice-president, Carlos Lage, went on to take part in a poorly attended “alternative” summit. There they blamed the United States, the IMF and Europe for poverty in Latin America. Other governments are quietly looking for solutions closer to home. But they are less skilled than Mr Chávez at making news.

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Venezuela

Challenging Chávez-for-life

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From The Economist print edition

A new kind of opposition

AFP

Get article background

A supporter of constitutional reform

THE history of Venezuelan politics over the past eight years is littered with failed attempts by the opposition to halt the progress of the country's increasingly authoritarian leftist president, Hugo Chávez. These included an abortive coup in 2002 and a prolonged shut-down of the vital oil industry a few months later. “With failure after failure,” reflected Teodoro Petkoff of *Tal Cual*, an anti-Chávez newspaper, in an editorial this week, “the mistake of basing a strategy on the search for ‘fast-track’ solutions became clear.” But with a referendum on a controversial constitutional reform due on December 2nd, the government seems to have been wrong-footed by an opposition student movement whose leaders neither seek to oust the president nor to stray from constitutional norms.

The students started to march and protest in late May when Mr Chávez refused to renew the broadcasting licence of the main opposition television channel, RCTV, on the grounds that it had supported the 2002 coup. Although they failed to reverse the decision, they helped bring the issue of free speech to international attention. Now they are attempting to derail the president's bid to change the constitution to allow his indefinite re-election and to entrench his revolution by turning Venezuela into a socialist state.

The students have staged several big marches in the centre of the capital, Caracas, which Mr Chávez's supporters consider to be their own territory. The student leaders say they want to press the parliament, the supreme court and the electoral authority to delay the referendum on the grounds that only a tiny minority of voters are familiar with the sweeping constitutional changes proposed.

The students' arguments chime with complaints from a segment of Mr Chávez's own supporters who have broken with him over the constitutional reform. These include Podemos, a small democratic socialist group, and Raúl Baduel, who stepped down as defence minister earlier this year and who as commander of the armoured division during the 2002 coup was instrumental in returning Mr Chávez to power. General Baduel and Podemos have both called for a “no” vote in the referendum. They argue that the constitutional changes hand more power to the president at the expense of the citizen, and that they are illegal since they should have been discussed by a Constituent Assembly, rather than the parliament. If the reform goes ahead, this would amount in practice to “a coup”, General Baduel said.

Mr Chávez has dismissed the students as spoiled “rich kids”, angry at the prospect of losing their privileges. He alleges that they are part of a “fresh fascist onslaught, supported by the media”. The government has deployed against them counter-demonstrators, who hurl insults—and sometimes rocks and bottles—from behind lines of riot police. After a recent march, the campus of the Central University was transformed into a battlefield by *chavistas* armed with handguns and riding motorbikes, dozens of whom passed through police lines. When this was denounced by the university's rector, the interior minister, Pedro Carreño, dressed in the red shirt of a *chavista* militant, went on television to blame the university authorities and opposition students for the violent incidents. The students had tried to “lynch” their adversaries, he said.

Mr Chávez has often won political victories by luring the opposition into confrontation. A radical minority of the opposition favours abstaining in the referendum and has issued vague threats of direct action. It appears to have little support among the students. Opinion polls suggest a majority of Venezuelans may be against the reform. But a low turn-out may still hand victory to Mr Chávez on December 2nd.

In 1928, a student movement shook, but failed to dislodge, the lengthy dictatorship of General Juan Vicente Gómez. In 1958 students played a big role in a popular uprising against another Venezuelan dictator. Student leaders are well aware of these precedents. But they say they are not trying to overthrow the elected government, and argue that they are not a substitute for a credible political opposition. “We can't do it alone,” said Yon Goicoechea, one of the movement's leaders.

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The Latinobarómetro Poll

A warning for reformers

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Latin Americans expect more from the state and less from the market

DESPITE four years of solid economic growth and, in many countries, low inflation, Latin Americans continue to grumble about their democracies. In some countries in the region—though not in Brazil and Mexico, the two giants—they are becoming disillusioned with the market economy. But rather than socialism, they want a fairer distribution of income and a state that gives greater social protection. These are some of the conclusions suggested by the latest Latinobarómetro poll taken in 18 countries across the region and published exclusively by *The Economist*. Because the poll has been taken regularly since 1995, it tracks changes in public attitudes in the region.

The picture that emerges from this year's poll is somewhat contradictory. After a boost last year—probably the result of a dozen presidential elections in the region—support for democracy has fallen back slightly: only around half of respondents are convinced democrats (see table 1 and chart 2). In only five countries has support for democracy risen since last year: in Costa Rica and Panama, where popular social-democratic leaders are in office, and in Bolivia, Ecuador and Nicaragua, whose left-wing presidents, respectively Evo Morales, Rafael Correa and Daniel Ortega, represent constituencies who have previously felt excluded from power.

Wavering democrats 1

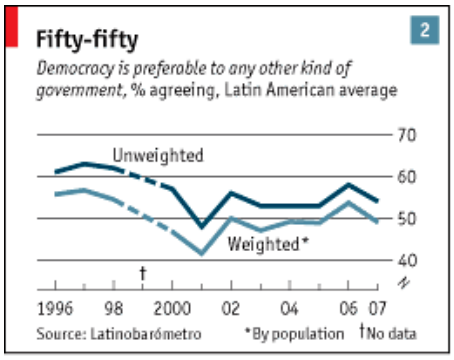
Which of the following statements do you agree with most? %

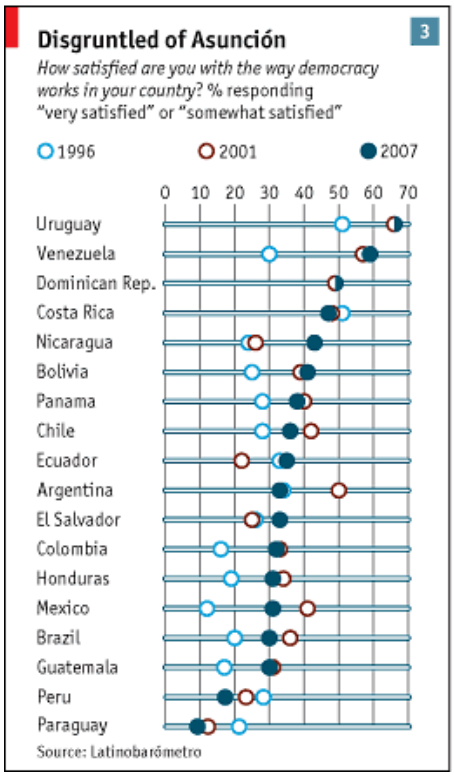
	Democracy is preferable to any other type of government					In certain circumstances an authoritarian government can be preferable to a democratic one				
	1996	2001	2006	2007	*Change since 2006*	1996	2001	2006	2007	*Change since 2006*
Costa Rica	80	71	75	83	8	7	8	9	5	-4
Uruguay	80	79	77	75	-2	9	10	10	10	0
Bolivia	64	54	62	67	5	17	17	18	14	-5
Venezuela	62	57	70	67	-3	19	20	11	14	3
Ecuador	52	40	54	65	11	18	24	21	13	-8
Dominican Rep.	na	na	71	64	-7	na	na	21	21	0
Argentina	71	58	74	63	-11	15	21	16	20	4
Panama	75	34	55	62	7	10	23	19	13	-6
Nicaragua	59	43	56	61	5	14	22	14	10	-4
Mexico	53	46	54	48	-6	23	35	15	14	-1
Colombia	60	36	53	47	-6	20	16	16	12	-3
Peru	63	62	55	47	-8	13	12	20	22	2
Chile	54	45	56	46	-10	19	19	13	21	8
Brazil	50	30	46	43	-3	24	18	18	17	-1
El Salvador	56	25	51	38	-13	12	10	15	20	5
Honduras	42	57	51	38	-13	14	8	12	17	5
Paraguay	59	35	41	33	-8	26	43	30	36	6
Guatemala	50	33	41	32	-9	21	21	35	33	-2

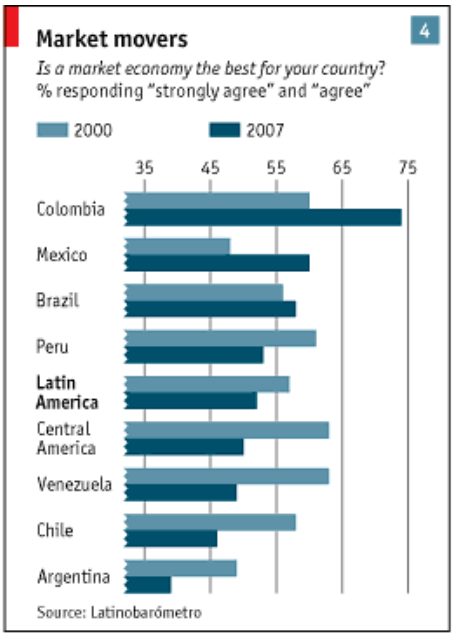
Source: Latinobarómetro

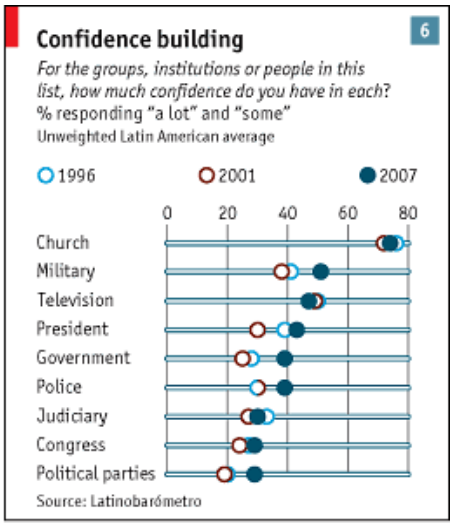
Apart from in two small Central American countries (El Salvador and Honduras), the biggest falls in support for democracy occurred in Argentina and Chile. That is odd, since both countries' economies are growing fast. In Argentina, some democrats may have become disillusioned by dynastic rule: a presidential election last month saw an easy victory for Cristina Fernández, the wife of the outgoing president, Néstor Kirchner. In Chile, Michelle Bachelet may have failed to meet the expectations of social change that she aroused when elected in 2006.

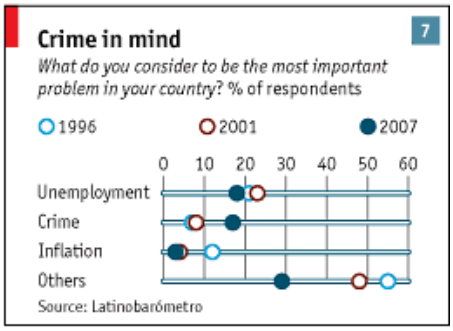
Fewer than a fifth of respondents favour authoritarian government. Support for authoritarianism has fallen in both Mexico and Brazil to 17%, down respectively from peaks of 35% (in 2001) and 25% (in 2000). In two poor countries, Guatemala and Paraguay, a small majority now favours authoritarianism—nowhere was that the case last year.











Paraguayans and Peruvians are the least satisfied with how their democracy works in practice (see chart 3). Overall, only 37% of respondents across all 18 countries pronounced themselves satisfied with their democracies, a similar figure to last year. But that is up from 25% in 2001.

Latin Americans are becoming similarly equivocal towards the market economy: this year's poll shows sharp falls of those responding affirmatively when asked whether this is the best economic model for their country (see chart 4).

Marta Lagos, the director of Latinobarómetro, says this reflects not just the persistence of poverty but also the impact of the “leftist discourse” of the likes of Hugo Chávez, Venezuela's president, against the United States and against the free-market formulae of the Washington Consensus. She adds that the poll does not show a demand for a fundamental change in the economic system but rather a desire for a more protective state.

Slightly over half of respondents across the region still favour the market economy. Private business is trusted slightly more than government. And support for privatisation continues to recover—though not in Argentina, where Mr Kirchner has preached in favour of nationalisation with a fervour similar to that of Mr Chávez (see chart 5). But many Latin Americans no longer seem to think that the market alone will bring them a fair share of the fruits of economic growth. Only 41% of respondents across the region think that governments guarantee equality of opportunity.

That is the main message for democratic reformers from the poll. Economic growth and democracy have improved the lives of many Latin Americans. But that in turn seems to have raised their expectations rather than making them more satisfied with the state of their nations. “After four years of growth people want to see that their slice of the cake is bigger,” says Ms Lagos.

Thanks to its bounteous oil revenues and Hugo Chávez's rapport with many of his country's poor, Venezuela stands out in the poll. Some 56% of respondents there said that the distribution of wealth in the country was fair, way above the regional average of 24%. Despite this, 63% of Venezuelan respondents said they had difficulties paying their bills each month, well above the regional average of 49%.

The poll finds that Mr Chávez is no more popular in Latin Americas as a whole than George Bush. He is considerably less popular than Brazil's Luiz Inácio Lula da Silva or Spain's king, Juan Carlos, and its prime minister, José Luis Rodríguez Zapatero (with both of whom Mr Chávez crossed words at a recent Ibero-American summit).

The poll shows that governments are steadily becoming more popular and many political institutions a bit less distrusted (see chart 6). One sign of better economic times is that fear of unemployment is falling steadily. For the first time, crime seems about to displace unemployment at the top of the list of problems in the region (see chart 7). If that trend continues, it could eventually see the region's political pendulum start to swing back towards the right after several years in which the left has been in the ascendant.

Latinobarómetro is a non-profit organisation based in Santiago, Chile, which has carried out regular surveys of opinions, attitudes and values in Latin America since 1995. The poll was taken by local opinion-research companies in 18 countries and involved 20,212 face-to-face interviews between September 7th and October 8th 2007. The average margin of error was 3%. Central America in chart 4 refers to an unweighted average of results from Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama. Further details from www.latinobarometro.org.

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Australia

Rudd in the home stretch

Nov 15th 2007 | BRISBANE
From The Economist print edition

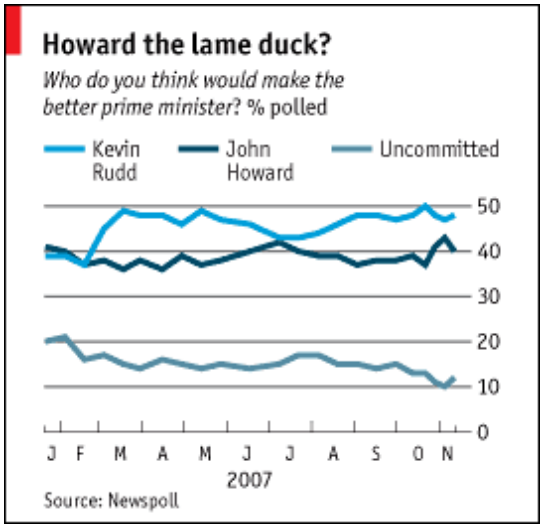
AFP

One of the most successful conservative premierships of recent years may be coming to an end

Get article background

A STRANGE atmosphere has enveloped John Howard's campaign to win an extraordinary fifth term for his conservative coalition government. Two months ago, after a crisis of confidence over lousy opinion polls, the prime minister said he would not serve a full term if re-elected. Yet on November 12th, officially launching his re-election bid in Brisbane, he spoke as if he were planning to stay on indefinitely, declaring repeatedly to the party faithful, "I want to tell you why I want to be prime minister of this country again."

Two days later Kevin Rudd, leader of the opposition Labor Party, made hay of the prime minister's apparent change of heart when he launched his own campaign in the same city. He accused Mr Howard of having no plans for the future "because he's not going to be there". And if opinion polls a week before the November 24th election are accurate, he is right: Mr Rudd has a commanding lead (see chart).



Although Mr Howard called the election a month ago, both leaders delayed their set-piece launches to give themselves a shot in the arm in the final fortnight. Both travelled from Australia's populous southern cities to Brisbane because the "sunshine state" of Queensland is where the election could be won or lost. Labor holds just six of Queensland's 29 seats in the federal parliament, and hopes to pick up there several of the 16 extra seats it needs for a majority in the 150-seat House of Representatives. Mr Rudd, himself a Queenslander, could prove one of his party's most formidable weapons.

Mr Howard landed in Brisbane in the fight of his political life. He is Australia's longest-serving prime minister after Sir Robert Menzies, his political hero who founded the conservative Liberal Party which Mr Howard leads. After more than 11 years in power, he has presided over Australia's longest boom in memory, and an economy entering its 17th year of uninterrupted growth. Queensland and other resource-rich states are enjoying a mining bonanza, thanks largely to demand from China. Yet despite this, voters seem to think Mr Howard has outstayed his welcome, and could have handed over prudently last year to Peter Costello, his younger heir-apparent.

An opinion poll on November 12th gave Labor a 10-point lead, after the distribution of second preference votes from small parties. This is the average poll advantage that the opposition party has maintained since January. Mr Howard warned Liberal parliamentarians a few months ago that such numbers meant “annihilation” for his government.

Five days before his launch, Australia's central bank raised interest rates by 25 basis points, the sixth increase since Mr Howard campaigned successfully at the last election in 2004 on a pledge to keep interest rates low. The bank followed this up with a warning that inflation was likely to exceed 3% next year, suggesting more rises are on the way. Government spending, the bank added pointedly, was contributing to inflationary pressures.

Ignoring the warnings, Mr Howard promised more than A$9 billion ($8 billion) more spending at his launch, on top of pledges costing A$43 billion since the campaign started. The most remarkable one was a tax rebate of up to A$800 for parents, regardless of income, to set against the cost of sending children to private schools, including fees, uniforms and excursions. If this was meant to trump Mr Rudd on an issue (education) he has made his own, it may not have worked. Economists and some school principals criticised the plan as welfare for the middle class; the money would be better spent, they argued, on fixing things in the schools themselves.

A youthful 50-year-old, Mr Rudd preceded his launch with a visit to cheering students at his old state school in Nambour, north of Brisbane. His launch had the zing of a leader who senses that power is within his grasp. He portrayed himself as “a kid from country Queensland”, whom education had equipped to be a diplomat and potential prime minister. He promised more spending on schools, universities, renewable energy and a national broadband network, which, he claimed, would cost less than a quarter of Mr Howard's splurge. With impressive chutzpah, he painted Mr Howard—leader of a party that stands for small government and free markets—as the irresponsible one.

Having entered parliament only in 1998, and taken over as leader of a dispirited party only last December, Mr Rudd has made extraordinary strides in reviving Labor's fortunes. His message seems to resonate with suburban Australians, though many remain troubled by the almost complete lack of substantive differences between the main parties. Moreover, despite the nightmare polls, Mr Howard retains a lead over Mr Rudd on the question of economic management.

Mainly because of that, a last-minute victory by Mr Howard cannot be ruled out. Yet, hard though the task will be to take 16 seats from the government, the election remains Mr Rudd's to lose.

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Pakistan's coup

When BB came marching home

Nov 15th 2007 | DELHI
From The Economist print edition

Benazir Bhutto launches herself into opposition against General Pervez Musharraf—and is arrested

AFP

Musharraf's men nab another threat to world security

Get article background

INVITING unhappy comparisons with Mahatma Gandhi and Mao Zedong, Benazir Bhutto, leader of the Pakistan People's Party (PPP), was foiled in a plan to lead a “long march” on November 13th. The march—in fact, a 270km (170-mile) drive from Lahore to Islamabad—had been called to protest against the imposition of martial law by General Pervez Musharraf, Pakistan's president, on November 3rd. Hours before it was to start, Miss Bhutto was put under house arrest for a week.

A few brave PPP supporters hit the road. In holding a political gathering, they defied the rules of General Musharraf's coup. Inaccurately, he has described this as constituting a state of emergency. In fact, the general has done away with the constitution altogether. He has also arrested at least 2,500 political activists, human-rights workers and lawyers. Private television news channels have been taken off the air; critics of the president and army now face three-year prison terms.

As they drove to Islamabad, the PPP's protesters also faced a threat of terrorism; twin suicide-blasts had devastated Miss Bhutto's return to Pakistan from exile last month, killing 150 of her supporters in Karachi. Yet all attention remained fixed on the Lahori townhouse—newly designated as a “sub-jail”—where Miss Bhutto, a two-time former prime minister, had been detained.

She proceeded to announce the end of year-long negotiations with General Musharraf to share power after a general election due in January: “There are no circumstances in which I could see myself serving with President Musharraf.” Rather, she said, the general must quit. Miss Bhutto then telephoned other opposition leaders, including several in exile, detention or hiding, to offer her party as an ally against him. Another former prime minister, her erstwhile rival, Nawaz Sharif, exiled leader of the Pakistan Muslim League (N), accepted the offer.

On the face of it, this was a dramatic turnaround by Miss Bhutto. She had returned from exile after the general granted her an amnesty from corruption charges relating to her time in power. For her part, she ordered the PPP not to quit Parliament, like every other opposition party, when General Musharraf got himself re-elected president by its members last month. Even after the general launched his coup, it was at first hard to know whose side Miss Bhutto was on. While thousands of members of other parties were arrested, the PPP's were left at large.

But the general has not seemed minded to give away his powers. His attorney general said he could step down as army chief before December 1st but that might not matter much. General Musharraf staged his

coup when the Supreme Court's judges seemed about to declare his presidential re-election illegal because he was a serving soldier at the time. He has since sacked 12 of its judges and appointed biddable alternatives. He has also refused to consider lifting emergency laws—perhaps until after the election is held. A poll held in those conditions would not be remotely fair.

It would be much like the last Pakistani election, in 2002, which took place under emergency laws imposed by General Musharraf after his 1999 coup, and was rigged on behalf of his principal supporter, the Pakistan Muslim League (Q), or PML-Q. Unable to make a majority nonetheless, the general's agents allegedly bought one, bribing and cajoling members of other parties to cross the floor to the “king's party”, as the PML-Q is called.

The general may hope to succeed with these tactics again, but it will be harder. In 2002, he was a fairly popular, efficient leader. This year, in response to food-price inflation and his own blundering efforts to quash the judiciary and media, his popularity has collapsed. According to polling by the International Republican Institute—sampled before the coup—83% of Pakistanis were against the state of emergency that was then rumoured.

A large majority also wanted the general to quit. They may be disappointed awhile. Asked this week when he would step down, General Musharraf replied: “When there is no turmoil in Pakistan.”

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Hong Kong

The iron ladies' contest

Nov 15th 2007 | HONG KONG
From The Economist print edition

A by-election about the territory's future

Reuters

Is Anson fairest of them all?

Get article background

IT MAY be only a by-election, but it is being portrayed as a vote on Hong Kong's future. It is certainly the biggest celebrity contest in the territory's voting history. On one side is Anson Chan, a former head of the civil service who wants full democracy at the next opportunity. On the other, Regina Ip, a former security minister who is not so sure. Neither are many voters.

Mrs Chan's decision in September to enter the December 2nd contest has upset the government in Beijing. Since her retirement in 2001, Mrs Chan has gradually emerged as a champion of democracy in Hong Kong. In a contest organised in September by pro-democratic parties to choose a candidate for the by-election, Mrs Chan (who has no party ties) won hands down. Opinion polls at first put her streets ahead of Mrs Ip, who is backed by parties close to the mainland government.

In the past few weeks the two ex-bureaucrats have been trying to reinvent themselves as politicians. Mrs Ip, 57, spent a night in a cramped apartment to experience the sufferings of residents caused by a nearby train line. Mrs Chan, a patrician 67-year-old, has been visiting the poor and standing on street corners handing out leaflets. Facing the occasional heckler, she says, has been a “humbling experience”.

Mrs Chan should not have to try this hard. The by-election is in Hong Kong Island, a constituency where around 60% of voters normally support democrats. In 2003 Mrs Ip became a target of the democrats' wrath for her brusque attempts as Hong Kong's security chief to promote an anti-subversion bill that they said would restrict civil liberties. Hong Kong is constitutionally required to pass such legislation, but huge protests and the withdrawal of support by some pro-government legislators forced the government to shelve the idea. Amid the furore, Mrs Ip resigned.

But much has changed in the past four years. In 2005, at China's quiet urging, the then widely disliked chief executive, Tung Chee-hwa, stepped down. Hong Kong's economy has revived. Mrs Ip has apologised for her handling of the bill (though she still defends its contents). She returned to Hong Kong this year after earning a master's degree at Stanford University. Her time abroad taught her that “it's much better for government if you have a mandate from the people”, she says. Mrs Ip's election platform calls for the chief executive and the legislative council (LegCo) to be elected by universal suffrage in 2012 (though she would not object to delaying this to 2016 for LegCo and 2017 for the chief executive). Despite widespread demands earlier this decade for quicker reform, many voters now appear content with such a timetable.

As Mrs Ip's support among pro-Beijing groups suggests, there is a catch. Nominees for the post of chief executive would need the support of at least 10% of each of four groups within a 1,800-strong nominating committee. One of these groups would represent the industrial, commercial and financial sector. Critics say it would be extremely difficult to persuade even a tenth of them to support a candidate disliked by Beijing, given their extensive business links with the mainland. Mrs Chan wants to set the threshold at 10% of the entire nominating committee. Mrs Ip's proposal, she says, is a “huge step backwards”.

Democrats concede that arguments over such fine detail do not excite voters. They fret that in elections to district councils on November 18th they will lose some of the gains they made in 2003 after the uproar over the subversion bill. Although Mrs Chan is still the frontrunner in the December 2nd ballot, they worry that her margin may be slim. And even if Mrs Ip loses, she is most likely to win in LegCo elections next

year that allow runners-up to get seats. All good training, perhaps, for an eventual bid to be chief executive.

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India's ragpickers

Scavenger hunt

Nov 15th 2007 | DELHI AND MUMBAI
From The Economist print edition

Disposing of rubbish, and wrecking livelihoods

TARA BAI, a ragpicker in Mumbai who was named after an Indian queen, shakes her head angrily when asked if she is disgusted by her job: picking through mounds of rotting refuse for sellable plastic and metal. “It's not like that; it's how I survive,” says the farmer's daughter, who moved to the city in 1972, when drought ended her rural life. But opening a fresh sack of rubbish to reveal millions of squirming maggots, she turns away as if to stop herself gagging.

No one knows how many ragpickers there are in India. In Delhi alone, there are more than 300,000. They earn 100-150 rupees ($2.50-3.75) for eight hours' work. They save the Municipal Corporation of Delhi (MCD) an estimated 600,000 rupees in daily waste-disposal costs, reckons Chintan, a charity that campaigns for their welfare.

A small improvement came last month when Delhi's government equipped 400 ragpickers with protective gloves and clothing. It is also giving them health-and-safety training and, if the scheme is successful, will repeat the exercise with another 4,000 scavengers. “It is to help them in their upliftment”, says Dr Sabata, an official at Delhi's environment ministry. Almost all ragpickers are *dalits*, once known as untouchables.

Ragpickers suffer from dreadfully high levels of illness, especially respiratory diseases. But health is not, at present, the main concern of the groups that campaign for them. In recent months, ragpickers in Delhi have been denied access to much of the rubbish upon which they depend. In its drive to spruce up the capital for the 2010 Commonwealth games, the MCD has awarded waste-collection contracts to private companies in six of its 12 zones. These firms dump rubbish in inaccessible containers without any thought for recycling. This is unsurprising. They earn six rupees per tonne of collected rubbish; sold on, that refuse would fetch just over five rupees. Chintan has researched the impact in two zones, and has found that half the ragpickers reported a substantial drop in earnings.

In Mumbai, waste collection has not yet been privatised, but it might be soon. “The government wants Mumbai to be modern, clean,” says Jyoti Mhapsekar, president of Stree Mukti Sanghatana, a charity that works with the city's poorest. “But it will take away the livelihoods of these people.” It will also, she adds, strip urban India of one of its few green credentials. Ragpickers, who leave no rubbish that is reusable, are the original recyclers; without them an impressive industry will be lost.

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Japan and America

Looking to the future, stuck in the present

Nov 15th 2007 | TOKYO
From The Economist print edition

No hiding the strain in Japan's relations with big brother

Get article background

THE first trip to Washington, DC by a new Japanese prime minister—Yasuo Fukuda of the Liberal Democratic Party (LDP) was on his way as *The Economist* went to press—usually follows a script. George Bush will probably josh too informally with Mr Fukuda, or mispronounce his name. Mr Fukuda will assure Mr Bush of the importance of Japan's post-war alliance with the United States. But away from the ritual, there is no hiding the strains in the alliance.

One is a hardy perennial: how much should Japan pay for American forces underwriting its defence? Japan is pushing to pay less. It is also uncomfortable at the pace of America's rapprochement with North Korea while the question of Japanese kidnapped by that country in the 1970s and 1980s remains unresolved. Mr Fukuda has said he wants Japan to play a more important role in the six-nation talks meant to get North Korea to disarm. But the domestic sensitivity about the abductees precludes this.

The biggest strain, however, has to do with the uncertain future of Japan's commitment to the American-led “war on terror”. This also lies at the heart of a domestic political crisis that helped bring down Shinzo Abe, whom Mr Fukuda replaced as prime minister in September, and has all but stymied the current government.

The chief manifestation of the commitment was the Japanese navy's presence in the Indian Ocean, resupplying other ships engaged in the fight against the Taliban and al-Qaeda. But that presence was thrown into doubt when the opposition Democratic Party of Japan (DPJ) seized control of the upper house of the Diet (parliament) in elections in late July. The DPJ's leader, Ichiro Ozawa, claimed that the operations breached Japan's pacifist constitution. He vowed to use his party's upper-house majority to block any attempt to extend the navy's presence. The Americans huffed and puffed but to no avail. The mandate expired on November 1st and the ships have been called home.

Internationalists in both main parties are mortified that Japan (not for the first time) appears unwilling or unable to play a role in the world commensurate with its size. Yet Mr Fukuda brings a small gift for Mr Bush. This week the lower house passed a bill authorising a new refuelling mission, albeit one heavily circumscribed: fuel and water may be used not for combat or even search-and-rescue missions, but only to help intercept shipping that might be supplying terrorists.

Recent farcical political events make it more likely that this bill will pass into law. In early November, Mr Ozawa surprised even those who thought they knew him by entering into talks with Mr Fukuda over a “grand coalition”, one in which he and his party would get plum government posts; the future of the refuelling mission was one of the bargaining chips. When Mr Ozawa brought the deal back to his party's executive, it was appalled. Mr Ozawa resigned, but a party with a dire shortage of good leaders reinstated him.

Such backroom dealing has made both parties look shambolic, but Mr Ozawa's DPJ is in greater disarray. Mr Fukuda now looks more likely to use his two-thirds majority in the lower house to override any upper-house veto of the refuelling bill. The DPJ might half-heartedly pass an upper-house motion censuring the government, but Mr Fukuda could ignore it. This week he talked confidently of hosting next summer's G8 meeting that takes place in Japan.

The irony is that Japan's refuelling contribution was in some ways a token. It became important because it raised the question of just how far Japan should support America. Even leaders such as Mr Abe, who argued for a more robust Japan, believed that could only be achieved by falling in behind American demands.

In Washington, Mr Fukuda will take a slightly different tack, pointing out that Japan's main priorities lie in Asia—implying that Japan should not be asked to sign up to every “coalition of the willing” proposed by America. Some Washington policymakers might agree. In a speech last week in Tokyo, Mr Bush's defence secretary, Robert Gates, while calling on Japan to shoulder “global responsibilities”, also called for a rethink of the alliance. It seems a promising suggestion, but not one likely to be acted upon soon. Mr Bush's administration has just a year to run, and Mr Fukuda may not last that long.

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Cambodia

Facing justice

Nov 15th 2007 | PHNOM PENH
From The Economist print edition

A UN-backed tribunal finally arrests the Khmers Rouges' foreign minister

Get article background

RESIDENTS of Phnom Penh had grown accustomed to seeing Pol Pot's foreign minister living it up. But generous donations to Buddhist temples and the ruling party turned out to be not enough to shield Ieng Sary from justice. This week he and his wife (also once a minister in the Khmer Rouge government) were arrested on the orders of the Khmer Rouge Tribunal, a United Nations-backed court run by Cambodian and international judges. They join two other Khmer Rouge leaders in custody. A third, Ta Mok, died last year.

But it is 82-year old Mr Ieng who had seemed to be most flagrantly getting away with mass murder. In 1979, he was sentenced to death along with Pol Pot by a “people's revolutionary tribunal”. In 1996, however, he led a breakaway faction that split the Khmers Rouges, hastening the end of its insurgency. He was rewarded with an amnesty which annulled the 1979 verdict. The tribunal's judges have had to sidestep the issue of trying him twice for the same crime by indicting him for “crimes against humanity and war crimes”. Diplomats also claim China has put pressure on Cambodia's prime minister to spare Mr Ieng, who was privy to the secret details of Beijing's unflinching support for the murderous Khmers Rouges in the 1970s.

The tribunal seems to have surmounted—or ignored—legal complexities and diplomatic obstacles. But Ta Mok's death and a stroke just suffered by Khieu Samphan, once the Khmers Rouges' head of state, is a poignant reminder that justice is more than ever a race against time.

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Malaysia

Not mellow yellow

Nov 15th 2007 | BANGKOK
From The Economist print edition

The largest anti-government protests for a decade

Get article background

NO SELF-RESPECTING protest movement leaves home these days without its own colour scheme. Last weekend, tens of thousands of Malaysians wore canary-yellow shirts to defy a government ban and march in Kuala Lumpur, calling for fairer elections. Riot police blocked routes into the city and fired water cannon to break up the rally.

These were the largest anti-government protests since 1998-99, when angry supporters of a jailed former deputy prime minister, Anwar Ibrahim, wore red and adopted the battle-cry of *reformasi* from neighbouring Indonesia. A decade on, the new buzzword is *bersih* (clean). But Mr Anwar is out of jail and again leading opposition to the entrenched elite he was once part of.

That entrenchment is maintained, says Mr Anwar, by dubious election procedures and a stacked electoral commission, supported by Malaysia's state-controlled media and a pliant judiciary. Pundits predict that the prime minister, Abdullah Badawi, will go to the polls early next year. This adds to the urgency of calls to overhaul the electoral system.

Those calls met a predictably cool response from ministers. But the message was not aimed only at them. In an echo of last year's anti-government uproar in Thailand, the yellow-clad masses marched to the palace of Malaysia's constitutional monarch to hand in a petition urging clean and fair elections. The palace sent a courtier to accept the document. In both Thailand and Malaysia, yellow is associated with royalty. The difference between the two is that while Thailand's crown wields immense clout, Malaysia's royals are figureheads. Yet that might change.

Under Malaysia's constitution, nine hereditary state sultans share a rotating five-year kingship. The sitting monarch signs bills into law, and formally appoints ministers and judges. But the rubber stamp hit back recently when the sultans refused to approve Mr Badawi's choice for chief justice of a federal court. This unusual setback came as Malaysian lawyers staged their own protest by marching through the streets of the administrative capital, Putrajaya, in September over alleged meddling in the selection of judges. Their ire had been aroused by a video clip distributed by Mr Anwar that appeared to show a notable lawyer offering senior judgeships for sale.

None of this is likely to make much difference to ordinary voters who look to the long-ruling party, the United Malays National Organisation, for stability and growth. The opposition is fragmented and it would take more than electoral reform to vote out a ruling coalition that won 199 out of 219 parliamentary seats in 2004. Raja Petra Kamarudin, an opposition activist, says a realistic target for the next election is 60 seats. Still, even that might be enough to unseat Mr Badawi, who is more vulnerable to his own conniving comrades than to any opposition firebrand. A judicial scandal, mass rallies and an emboldened royalty may not usher in an opposition victory. But it could spell trouble for the man at the top.

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South Korean politics

The lady stays loyal

Nov 15th 2007 | SEOUL
From The Economist print edition

The opposition pulls itself together

Reuters

Lee Myung-bak looks for encouragement from Park Geun-hye's Dad

Get article background

AS BEFITS a daughter of a former president and a presidential aspirant herself, Park Geun-hye has a house and garden in one of Seoul's most expensive districts. It is not hard to find. Residents and petrol-station attendants helpfully point the way. Yet her party's leader, Lee Myung-bak, who narrowly defeated her in a primary election to represent the Grand National Party in this December's presidential election, has not visited and until last week had not telephoned.

Mr Lee's tin ear to Ms Park and her supporters opened up dissension in the ranks and paved the way for Lee Hoi-chang, a former party chairman and twice a losing presidential candidate, to declare his candidacy yet again—this time as an independent. Mr Lee vowed to end the “sunshine policy” of aid to North Korea, thereby—it was thought—appealing to Ms Park's more conservative supporters.

This year's presidential election is beginning to look a bit like the previous one, in 2002, which also involved divisions in the Grand National Party, a third candidate (who withdrew at the last minute), Lee Hoi-chang's candidacy—and corruption charges. This time, Lee Hoi-chang's advisers say Lee Myung-bak is vulnerable to questions about his role in a fraudulent investment scheme from which he allegedly benefited while others lost out. Lee Myung-bak denies the allegations and says he will resign if he is found to have played a role in the fraud, known as BBK, the name of the failed investment company.

The candidate of the liberal ruling party, Chung Dong-young, has failed to capitalise on the opposition's infighting. Mr Chung lags behind Lee Hoi-chang, who in turn trails far behind Lee Myung-bak, according to opinion polls.

In 1997, the Grand National Party, then in power, blew a large lead by squabbling; it does not want that to happen again. The desire for unity has increased Ms Park's power to demand concessions in return for support. Lee Myung-bak capitulated this week, promising to co-operate with Ms Park on future policy decisions, and blaming himself for disunity. “I have been inconsiderate,” the contrite former mayor of Seoul says. That was enough to win Ms Park's endorsement.

Lee Hoi-chang's supporters are unperturbed, vowing to continue the fight until the December 19th election. “What will happen when the BBK founder returns to Korea to defend himself?” they ask.

Lee Myung-bak's supporters are equally unperturbed. They point out that their candidate weathered weeks of withering criticism from Ms Park about BBK during the primary election and his support remains solid. With Ms Park now endorsing the front runner, they expect Lee Hoi-chang's support to ebb. If polls are any guide, the bulldozer—as Lee Myung-bak is known—is still on course for victory.

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Congo

A humanitarian disaster unfolds

Nov 15th 2007 | RUTSHURU
From The Economist print edition

Reuters

One year after the Congolese elections, civilians flee renewed fighting in the east

Get article background

AMONG the crowd of displaced civilians clamouring for food stood a young boy. He had fled his village and was left with little but a filthy T-shirt that read: “I'm voting for Kabila, the peacemaker”.

A year ago, Congo did indeed hold elections that many had feared would never take place. They were won by the incumbent president, Joseph Kabila, largely thanks to support in the east, which he promised to pacify. But for the people of North Kivu, an eastern province at the heart of a decade of war, the aftermath of the voting has brought anything but peace. Some 500,000 civilians have fled their homes, out of a total population of about 4m, to escape the growing fighting between the army, rebels and militias. In the past two months alone, more than 160,000 people have been displaced.

Making comparisons between humanitarian crises may not always be fair or useful. But those dealing with the emergency in Kivu are starting to do so. “The situation at the moment in North Kivu is worse than Darfur,” says Sylvie van den Wildenberg of the UN mission in the province. Many more people have fled their homes this year than in Darfur. Refugee camps are starting to pop up just outside the provincial capital, Goma.

Congo's last war, which officially ran from 1998 to 2003 but is still simmering in North Kivu, was the world's deadliest since 1945: some 4m people died. Most were silent deaths from hunger or disease, rather than bullets, blades or bombs. The current crisis in North Kivu is now adding daily to the death toll. Aware that they and their homes are targets for all sides, civilians flee at the first sign of fighting, many blending into the bush. Many villages are empty, while those sheltering the displaced are starved of bare necessities by roadblocks and attacked by gunmen.

Some make it to camps. But there is no guarantee of safety. Cholera and malaria continue to kill, mostly the children. And sometimes, as on November 13th near Mugunga camp, just 15 kilometres (9 miles) west of Goma, fighting erupts; this time 30,000 people had to flee again. “We are seeing this repeated displacement of civilians, which is exacerbating the problem. People who have already fled are having to flee again,” says Jane Coyne, head of Médecins Sans Frontières in North Kivu.

The conflict has taken on another dimension of brutality too. Women have been raped on an unprecedented scale, in the thousands. According to experts, rape is being used as a weapon of war. Such are the scale and violence of the attacks in eastern Congo, claims Yakin Erturk, the UN's special rapporteur on violence against women, that they constitute a war crime. Rape is being carried out by all sides and, worryingly, by civilians too.

Pity the UN

Stuck in the middle is the world's largest UN peacekeeping mission. Its soldiers are meant to protect civilians and support the army. But neither party is satisfied. On November 5th, 27 Indian peacekeepers were injured when attacked by a mob of hungry civilians who claimed not to have received any food aid. Other peacekeepers were stoned by government troops, angry that the UN had prevented them from trying to achieve a total military defeat of the rebels.

Much of the latest violence is attributed to Laurent Nkunda, a dissident Tutsi general who now leads a rebellion. But, to complicate matters, American diplomats trying to resolve the crisis have persuaded the Congolese army that Rwandan Hutu rebels, who operate from North Kivu, must be dealt with as well as Mr Nkunda. These rebels were at the heart of Congo's decade of violence and were twice cited by Rwanda as a reason to invade Congo.

Rwanda is backing Congo. But it says it wants the government and the UN to come up with plans to defeat the Hutu rebels by the end of the month. With another military front opening up, the humanitarian crisis is sure to continue.

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Somalia

Cast adrift

Nov 15th 2007 | DJIBOUTI
From The Economist print edition

The world turns its back on Somalia

Get article background

THE escalating violence in Mogadishu, Somalia's ruined capital, continues unabated. The fighting there in the last week has been awful. Over 80 people have been killed, some of them children. The bodies of Ethiopian soldiers killed in gun battles with Islamist fighters were dragged through the streets by angry mobs, beaten and spat on. Those grisly scenes were reminiscent of the treatment of American soldiers killed in Mogadishu in 1993.

A report this week by the EU claims that as many as 5,000 people have been wounded in the fighting in Mogadishu this year; 800,000 civilians are now displaced across the country. And the two sides are squaring up for more blood-letting. The leader of the ousted Islamists, Hassan Dahir Aweys, has called for a general uprising against Ethiopian and Somali government forces. Somalia's president, Abdullahi Yusuf, an old adversary of Mr Aweys, responded by demanding that civilians drive militants out of their own neighbourhoods or face the consequences.

Worse, perhaps, is a sense that Somalia is now being deserted by foreign countries. The harvest in central Somalia seems to have failed; some think it the worst in 13 years. Over 1m Somalis are now thought to be dependent on humanitarian assistance, but only a fraction of the needy are being reached. Despite international promises to tackle piracy off the coast, it remains at record levels, making it harder to ship in food aid. A famine is likely.

This week also saw the admission by the UN secretary-general, Ban Ki-moon, that there was no chance of a UN peacekeeping mission in Somalia. That was a big blow to those hoping to get the country back on its feet. The best Somalia can hope for, Mr Ban says, is a “coalition of the willing”. At the moment there are just the unwilling.

Ethiopia leads the heavy fighting against the Islamists on behalf of the sometimes ghostly Somali government. But it wants to get its troops out as soon as possible. Uganda is the only country to send in peacekeepers. It has 1,600 troops in Mogadishu under Africa Union (AU) command, but they are holed up at the airport. There is little chance now of the other AU troops promised by Burundi, Nigeria and others turning up. It looks as if Somalia is being cast adrift.

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Iraq and Syria

The plight of the refugees

Nov 15th 2007 | DAMASCUS
From The Economist print edition

Syria is finding it hard to cope with the flood of refugees from Iraq

Get article background

Reuters

Damascene survival

"DO YOU have a job?" and "What are you doing at the moment?" are leading questions on the whiteboard in an English lesson at an Iraqi refugee community centre in Sayyida Zaynab, a suburb on the edge of Syria's capital, Damascus. The students can expect more such requests for personal data in the coming weeks as the Syrian government and the UN carry out a census to count those who have fled from neighbouring Iraq.

Syria has taken in the lion's share of Iraq's refugees, about 1.5m of them, of whom well over half are probably Sunni, some 15% Shia and maybe 10% Christian. Jordan is thought to account for another 600,000 or so, but no one knows exactly. The Syrian survey will assess the needs of the refugees—and their effect on the host country, which has 19m of its own citizens. Many refugees are running out of savings, slipping into poverty, sometimes into crime and prostitution.

The count will be difficult. If they were all in camps, it would be easier, says Kristele Younes of Refugees International. "It's the first time in the UN's history that there's been an urban crisis of such huge proportions," she says. "They are people who are very difficult to 'see'. They speak Arabic and look pretty similar [to Syrians]. It's almost a ghost population."

In Sayyida Zaynab, near a Shia shrine to Zaynab, the Prophet Muhammad's granddaughter, the streets teem with Iraqis. Shops have been taken over by Iraqis, restaurants such as the Bakery Bagdady [sic] sell Iraqi specialities unknown to Syrians, and travel agents offer trips to the border for 500 Syrian pounds ($10). Some 350,000 Iraqis may have moved into this area alone, putting a strain on water and electricity supplies as well as on schools.

The Syrian Arab Red Crescent, together with the Office of the UN High Commissioner for Refugees (UNHCR), has opened a clinic to cope with the influx of sick Iraqis. Inside, the waiting area is packed. Dr Akram al-Hasani, a Syrian orthopaedic surgeon, is examining a Basra man still suffering from an arm wound after being shot four years ago. "We have many trauma victims," he says. "And a large proportion of children with congenital problems, more than among Syrians."

In the mainly Christian district of Jaramana, a clinic at the Deir Ibrahim Khalil convent has an equally wide range of problems. "Depression, depression, depression," says Sister Malekeh, a Greek Catholic nun. "It's very sad. Now we have a psychiatrist who started two months ago. Before they didn't accept it and wouldn't come to the clinic, but now they have started to come."

In a census in 1987, there were said to be 1.4m Christians in Iraq. In the 1990s, the figure shrank to 1m or so. After Saddam Hussein's demise, they began to be targeted, mainly by Sunni groups linked to al-Qaeda, so most have now fled. An Anglican churchman says that some 1.25m Iraqi Christians now live outside Iraq, with about 250,000 left behind.

International aid workers are queuing up to work in Syria, to relieve the burden on the UN agencies and on the Red Crescent. Eight charities, including Islamic Relief and the Norwegian and Danish Refugee Councils, have been negotiating for months to start projects. The foreign ministry has given its approval,

but they must work under the umbrella of the local Red Crescent, which has been slow to reach agreement with the various groups. The Ministry for Social Affairs and Labour, which oversees local NGOs, says that Syrian ones should work mainly for Syrians.

Moreover, Syrian attitudes to Iraqis are hardening, as the numbers overwhelm local services. The government also worries about the cost of providing the extra population with heavily subsidised bread, fuel and other goods.

The UNHCR has managed to register only 135,000 refugees, a fraction of those who have arrived. And they are still trickling in, despite new rules that have in effect closed the border. Only certain favoured categories of applicants, such as lorry drivers, businessmen, academics and engineers, are now being allowed in, with occasional exceptions for the sick.

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Iran

The enemy within

Nov 15th 2007 | TEHRAN
From The Economist print edition

Not content with taking on the world, the president picks a few fights at home

Get article background

THE president of Iran, Mahmoud Ahmadinejad, has shown no signs of backing off in his confrontation with his critics abroad. Now, it seems, the gloves are off at home as well.

In recent speeches, Mr Ahmadinejad has not only vowed to pursue Iran's nuclear program, despite growing international pressure. He has also dismissed UN sanctions and brushed off the chances of an American attack. Iran's president has long scorned the reformists who ran the country under his predecessor, Muhammad Khatami, as weaklings who sapped the vigour of the 1979 Islamic revolution. But on November 12th Mr Ahmadinejad lashed out at fellow conservatives too, denouncing those who counsel greater caution as traitors, threatening to “expose” them. And on November 14th the government did just that, openly accusing a former nuclear negotiator, Hossein Mousavian, of spying for the British.

The harsh words and actions appear to come as a response to a groundswell of criticism from powerful establishment figures in Iran. Hashemi Rafsanjani, a former president said to be close to Mr Mousavian, recently gave warning that the danger of American attack was serious. The mayor of Tehran, Muhammad Qalibaf, seen as a likely conservative candidate for presidential elections in 2009, has been even blunter. He has said that officials should act with more “maturity, intelligence and cunning”, adding that the cost of Iran's diplomatic grandstanding has been unnecessarily high.

Given that most Iranians believe that their nuclear programme is peaceful, and that the world treats them unfairly, such sparring may seem to be just a squabble over tactics. But the factional antagonism runs deeper than the nuclear issue.

Ordinary Iranians are painfully aware that the sanctions that have mounted in response to the president's abrasive rhetoric help fuel inflation that is running at 16%. Businessmen complain that, with foreign banks reluctant to handle Iranian accounts, trade gets more tricky and costly. And while liberals chafe at growing restrictions on individual freedoms, even religious conservatives protest that Mr Ahmadinejad has diverted resources to wasteful projects and replaced competent administrators with ideologues.

Mr Ahmadinejad's tireless speechmaking, religious fervour and nationalism still inspire many poor Iranians. But within the establishment, which is to say among the educated class elevated politically by the revolution, doubts have spread as to whether the president's hardline populism could lead to a dangerous polarisation. With a combination of business interests and some senior conservatives increasingly ranged against him, the president may feel forced to rely on more repressive tactics.

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Gaza Strip

Tunnel visions

Nov 15th 2007 | RAFAH
From The Economist print edition

Ingenious ways to survive a blockade

Get article background

AP

The economy goes underground

SEVEN Gazans died this week when Hamas gunmen fired on Fatah supporters at a rally commemorating Yasser Arafat, the founder of Fatah and the Palestinians' long-time leader. For Gazans, who have enjoyed months of relative calm since Hamas took control of the strip from Fatah-loyalist Palestinian Authority forces in June, it was a jarring reminder of the factional violence that had claimed dozens of lives in the months before.

But while Hamas faces increasing dissent from Fatah and other factions, it—and Gaza—are so far fending off the effects of a trade blockade that Israel has imposed, thanks to an explosion in smuggling.

The strip's southern border with Egypt, a no-man's land roamed by tanks until Israel pulled its settlements out in 2005, is now dominated by colourful encampments which cover the entrances to smuggling tunnels, used to ferry goods and people from Egypt into Gaza. Once a secretive and dangerous industry, smuggling has become open, even respectable. As recently as last year, Israeli jets would destroy any sites suspected of housing tunnels, but now the smugglers are working in clear view of Egyptian border posts and Israeli surveillance.

Egypt says that restrictions on the strength of its forces in Sinai prevent it from clamping down on smuggling. The reason for Israel's forbearance is less clear. It has often said that the tunnels are used to import sophisticated weapons into Gaza that threaten its security. If so, they are not lying around in plain view in the border area; but much in evidence are rocks of chalky TNT used in the production of Gaza's home-made rockets.

However, the tunnels are used for much more than munitions. Nasser, a pharmacist in Rafah, says that he receives regular visits from smugglers offering to supply him with medicine bought in Egypt. While he does buy dried milk and drugs, his most popular import is generic Viagra, made in India, which he sells for 75 cents a tablet.

Israel declared Gaza a “hostile entity” last month and promised more restrictions. But as it tightens them and poverty rises, smuggling becomes a more attractive risk. Abu Adnan, a 21-year-old, said he had been working in Rafah's tunnels since he was 14 and can make around $7,000 per shipment. He has smuggled weapons, people and cash, but now the most popular import is cigarettes which Israel has stopped.

The smugglers are almost always private entrepreneurs. They first select a piece of land close to the border wall and then dig a large hole with a mechanical digger. They then enclose an area of dozens of square metres and start digging, filling the first hole with the earth from the tunnel. They can map the length and direction of the tunnel accurately using satellite pictures from Google Earth.

Tunnels are equipped with lighting and telephones. Pumps provide air, and winches drag trains of jerry cans over the smooth surface of the tunnel floor. The cans can be filled with earth, merchandise or people.

Mr Adnan complains that the increase in the number of tunnels is driving down profit margins. So is the

heavy taxation imposed by the Hamas police. But there are always new opportunities. Israel has threatened to reduce fuel supplies to Gaza; so Mr Adnan and his friends are already planning a pipe to import subsidised fuel from Egypt.

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Correction: Ugandan guards

Nov 15th 2007
From The Economist print edition

Our article on Ugandan guards working in Iraq, written for us by a freelance journalist in Uganda, was drawn substantially from an article published previously in Uganda's *Daily Monitor* and written by David Herbert. We were, of course, unaware of this. We apologise to Mr Herbert, the *Daily Monitor* and our readers.

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France on strike

Let battle commence

Nov 15th 2007 | PARIS
From The Economist print edition

MAXPP

President Nicolas Sarkozy faces his toughest fight so far

Get article background

IN A wintry November 12 years ago, a first-term French president brought weeks of chaos to the streets and paralysis to the railways by trying to end the country's generous “special regimes” for public-sector pensions. In the end, Jacques Chirac's government did what French governments do best: it backed down and dropped the whole plan.

This week, another new president, Nicolas Sarkozy, was confronted with what some hard-left union leaders promised would be a replay of 1995. On November 14th railway, bus and metro workers brought France to a standstill on the first day of a rolling strike against similar plans to end the special regimes. The unions already held a one-day strike in October. This time, the strike was open-ended, marking the start of the most testing period of Mr Sarkozy's presidency. On November 20th teachers, town-hall staff, post-office workers and other civil servants are due to strike. A week later it will be the turn of magistrates. And militant students have put up blockades on 20-odd university campuses. In two cases, riot police were sent in to clear them.

Officially, this week's strikes were against the government's plans to end the special regimes. These allow railway, electricity and gas workers, plus a few others in “arduous” jobs, to retire on full pension after only 37½ years of pension contributions, rather than 40 years in the rest of the public sector. Some 500,000 workers, and 1.1m pensioners, benefit from these regimes. Over the next four years, Mr Sarkozy wants to lengthen the required contribution period to 40 years.

In reality, the trial on the streets is over a lot more than a single reform. It is about Mr Sarkozy's overall determination to face down the opposition of left-wing conservatism to any change. Victory over the special regimes could stiffen his resolve to push through his other reforms. These include lengthening to 41 years the required pension-contribution period for all workers, as well as changes to the labour market and the benefit system. Some French commentators have started to call this the president's Thatcher moment. “Can Nicolas Sarkozy be a French Margaret Thatcher?” asked *Les Echos*, a business newspaper. “Is Sarkozy ready for a long trial of strength with the unions à la Thatcher?” mused *Le Parisien*, a daily.

What are the chances of his fluffing it, as his predecessors did? There are three reasons to hope that Mr

Sarkozy might fare better. First, he has hidden nothing from the French. In the past, many reform-minded leaders, on the left and the right, have tried to introduce changes by stealth. In 1995, for instance, Mr Chirac had campaigned not to reform France but to “mend the social fracture”. Lionel Jospin, a Socialist prime minister, managed to privatise a swathe of French companies without once using the term. Mr Sarkozy, by contrast, spelled out in his election campaign exactly what he would do.

He continues to make the case. “The French have approved these reforms. I told them everything before the elections. That's why I will carry through with these reforms right to the end,” he said to the European Parliament on November 13th. As Christian de Boissieu, head of the official Council of Economic Analysis, puts it, “this is arguably the first time a political leader in France has planned a reform and actually used the word.”

Second, there is a marked change in the public mood since 1995. Then, despite the chronic disruption, public opinion was broadly behind the protesters. At various points in November and December 1995, between 54% and 62% of those asked by CSA, a pollster, said they were sympathetic to the strikers. This time, however, poll after poll confirms that the public has switched. Even in *Libération*, a leftist newspaper critical of the president, one survey suggested that fully 59% of respondents backed him rather than the strikers.

Third, Mr Sarkozy, a careful student of recent French strikes, has tried to adopt a less clumsy approach to union relations than his predecessors. In 1995 Alain Juppé, Mr Chirac's prime minister, treated unions with haughty contempt. In 2006 Dominique de Villepin, then prime minister, did not bother to discuss a labour-market reform that he pushed through by decree. Like Mr Juppé, he had to withdraw the plan in the face of widespread protests.

Mr Sarkozy, by contrast, has piled on the charm with union leaders, taking them to lunch in posh restaurants and stressing that his door is always open. Indeed, Mr Sarkozy's aides dislike the Thatcher comparison, arguing that they have no intention of employing brutal tactics to get their way. Even as the strikes began this week, Xavier Bertrand, the energetic labour minister, was opening the way to fresh talks with union leaders. He would not budge on the basic principle of 40 years of contributions, he said. But he was happy to sit down with the unions and the transport bosses to look at details. Pierre Mongin, head of the Paris metro, said that, for his employees, these could include the introduction of a higher pay scale for those in their final pre-retirement years.

A show of force by the unions might actually suit Mr Sarkozy. Winning a symbolic fight could strengthen his hand in pursuing other contested reforms, including a rationalisation of the country's tribunal system and a loosening of the labour market. Bernard Thibault, head of the communist-backed Confédération Générale du Travail, the biggest railway union, knows this, commenting that he suspected Mr Sarkozy of “wanting this conflict to set an example”. From January, railway strikes will lose some of their potency when a new law requiring a minimum service on public transport takes effect.

At the same time, Mr Sarkozy is unlikely to get the victory he wants without giving a bit of ground. It depends on how much. In the past, he has often talked tough, but paid a high price to secure a deal. When he was finance minister, he agreed to the state taking on the pension liabilities of utilities in return for the unions dropping their opposition to partial privatisation. Only last week, when French fishermen complained about rising fuel prices, he flew to Brittany and announced a six-month waiver on their social charges. During the election, he promised a break with bad old ways. The deal he does on special regimes needs to be scrutinised to see how far he keeps his word.

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Georgia in turmoil

Caucasian circle

Nov 15th 2007 | BATUMI AND TBILISI
From The Economist print edition

An election is called, emergency rule is ended, but the damage lingers

Get article background

TO A visitor who has not seen Georgia since the “rose revolution” of 2003, the changes are stunning. Grand buildings ruined by war and neglect have been restored. Where there was night-time gloom there is now light. Roads have been repaired and chronic energy shortages are a thing of the past. Money is being poured into infrastructure and schools.

In Batumi, which in 2003 was outside central-government control, new hotels sprout everywhere. In the past two years Armenian tourists have returned. One reason is that, after the rose revolution, President Mikheil Saakashvili sacked all the traffic police, who had previously done little except extract cash from anybody on the roads. “It used to cost $100 in bribes to drive here from Armenia,” says Levan Varshalomidze, head of Batumi's local government. This year the Georgian economy should grow by 10%, despite a Russian economic blockade.

This all makes recent events in Georgia more depressing. On November 7th the government cleared opposition protesters from Tbilisi's main street after five days of demonstrations. The move went wrong as the opposition called in reinforcements, provoking riot police into liberal use of batons and tear-gas. A state of emergency was declared and opposition television stations were taken off the air. The next day Mr Saakashvili declared that he would hold a snap presidential election on January 5th. “You wanted early elections,” he said. “Have them even earlier!” This week the government announced the lifting of the state of emergency, too.

At the start of the protests, Salome Zourabichvili, a former French ambassador who became Georgia's foreign minister before being sacked by Mr Saakashvili, said that the government liked to show reconstruction to foreigners to mislead them. “We are living in a Potemkin country,” she scoffed. This is unfair, but life is hard for most Georgians. Former industrial towns such as Zestaponi and Kutaisi remain devastated by the collapse of the Soviet Union. The countryside is dotted with skeletal remnants of factories. One of Georgia's biggest exports is scrap metal.

Expectations of Mr Saakashvili were so high that they could only be dashed. Alex Rondeli, an analyst, suggests that part of the problem is that no politician who wants to stay in office can be truly honest about how long rebuilding Georgia is going to take. “It will take time,” he says, “more than one generation.” Mr Saakashvili and his friends have been tough and acted quickly, but in the process they have made enemies. Many claim that Mr Saakashvili has let power go to his head.

If he is no longer half as popular at home (and abroad) as he once was, it still seems likely that he will win the presidential election. Badri Patarkatsishvili, a tycoon, has declared that he will run. The opposition is furious because this may divide the anti-Saakashvili vote. According to David Usupashvili, leader of the Republican Party, the aim of the ten-party opposition coalition, who have chosen Levan Gachechiladze, a former businessman, as their candidate, is to scrap the present presidential system. “We are not searching for a better Saakashvili,” he says.

The opposition may suffer from claims that some of its leaders were in contact with Russian spies during the protests. Russia still backs two breakaway Georgian enclaves, Abkhazia and South Ossetia. As Giga Bokeria, an associate of Mr Saakashvili's, notes, “Moscow's declared goal here is regime change.” That is why European and American attacks on the government's crackdown on the Tbilisi protests have caused irritation. Outsiders report that Mr Saakashvili is in high spirits, untroubled by the criticisms, which he brushes aside as ill-informed. Mr Rondeli notes of Russia that “we are in a cage with a cruel dog who is biting us. We are asking Europe to open the cage and let us out but all they say is: ‘be nice to the dog.'”

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Croatia

Looking to Brussels

Nov 15th 2007 | ZAGREB
From The Economist print edition

Croatia dreams of escape from the usual western Balkan troubles

EACH November the European Commission issues reports on candidates for European Union membership from the western Balkans. These are awaited, rather like school reports, with some trepidation. This year's put Kosovo and Bosnia bottom of the class. Serbia's behaviour leaves much to be desired. Croatia comes top—but it could do better.

The next few weeks are busy in the Balkans. On November 17th Kosovo Albanians go to the polls. A week later it is Croatia's turn. Bosnia is looking for a new prime minister. Looming over all is the future of Kosovo, which may soon declare unilateral independence from Serbia. Yet Croatia hopes that it may be the one that gets away from the Balkan gloom.

Croats have reason to feel pleased with themselves. Last month their country was elected to the United Nations Security Council. In April it may be invited to join NATO. A Croat heads a new Balkan regional group based in Sarajevo. “It is no longer a question of light at the end of the tunnel,” says Miroslav Kovacevic, a close ally of the prime minister, Ivo Sanader. “We are out of the tunnel. Ten years ago we were constantly on the agenda of the Security Council; now we are on the council.”

Vladimir Drobnjak, Croatia's chief EU negotiator, is bullish too. He says the country aims to be ready to join in 2009. But he admits that a big problem is administrative capacity. Croats who need something from the government, such as a paper or permit, know all about this. They find it almost as infuriating as the clogged justice system and corrupt bureaucracy.

At least the economy is doing well, with growth expected to be 5.9% this year. Unemployment recently hit its lowest level since the end of the war in Croatia in 1995. Foreign investment is pouring in. But Masa Kovacevic, at the UN Development Programme, notes many things that could be done much better. Youth unemployment is 29%. The Serb and Roma minorities still face severe discrimination. Former war zones remain blighted.

The two main parties are running neck and neck before the election. The ruling Croatian Democratic Union has been hit by accusations of corruption. Its leaders respond that revelations of misdeeds in high places are proof that they are doing something about it. Not so, says Andrea Feldman, a civil activist. “There is no sense of responsibility in this government,” she says. The commission's report notes tartly that “no indictment or verdict has been issued in any high-level corruption case.”

Whether the Social Democrats can capitalise on this to win is uncertain. Ivica Racan, their longstanding leader, died in April. His successor is Zoran Milanovic, a former diplomat, but internal politics will make Ljubo Jurcic, a more lacklustre figure, prime minister if the party wins. Croatia's future EU membership should still be secure, even if it comes later than 2009. That is more than can be said for any other western Balkan country.

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Denmark's election

Fogh lights on

Nov 15th 2007 | COPENHAGEN
From The Economist print edition

The centre-right wins, just—but the prime minister eyes another job

IT WAS nailbitingly close, but in the end Anders Fogh Rasmussen won his gamble. The Danish prime minister had called an election 15 months early, confident that the exceptionally strong economy of recent years would secure an unprecedented third term for his centre-right "blue" coalition. When the votes were counted on November 13th, the blue block seemed to have exactly 90 seats, just enough for a majority—although it later emerged that one Faroese member of the Folketing was but a lukewarm supporter, so the government's grip may be uncertain.

EPA

Smooth loser, smiling winner

The short election campaign threw up three big surprises. The first was that a much-heralded revolt of the centre faded abruptly. Pundits hailed the rise of a new party led by Naser Khader, a Syrian immigrant with a Palestinian father. At one point it looked as if his New Alliance would take 13-14 seats. But his campaigning was lacklustre, and he was damaged by a refusal to state firmly that he would support Mr Fogh Rasmussen's blue block. New Alliance was left with just five seats. Mr Khader is now likely to support the coalition from outside, like the far-right Danish People's Party under Pia Kjaersgaard.

Ms Kjaersgaard's performance was the second surprise. Copenhagen cognoscenti had predicted that she would lose ground, thanks to the hostility of Mr Khader and because many Danes have become uncomfortable with her strident anti-immigration views. In fact her party's share of the vote rose yet again, taking it up to 25 seats. That will surely limit any hopes the government (and Danish business) might have of an early loosening of the country's tough anti-immigration laws.

The third surprise was the smooth performance of the main opposition leader, Helle Thorning-Schmidt. Ms Thorning-Schmidt, who is a daughter-in-law of a one-time British Labour Party leader, Neil Kinnock, is young and personable, but inexperienced. Yet she stood up well to Mr Fogh Rasmussen in television debates. Admittedly the Social Democrats did badly—indeed, this was their worst result in 100 years. But the centre-left "red block" held its ground. Ms Thorning-Schmidt seems sure to keep her job, and must have a good chance next time of becoming Denmark's first female prime minister.

When might that time come? Mr Fogh Rasmussen's paper-thin majority, plus the tensions within his coalition and with Ms Kjaersgaard, suggest that he will have a troubled government. Tricky issues such as a public-sector pay round and planned tax cuts loom. Moreover, he is said to be looking elsewhere, perhaps for a big international position. During the campaign, he openly and unexpectedly referred to his interior minister, Lars Lokke Rasmussen, as his probable successor. Few political analysts expect him to run for a fourth term, even though he is only 54.

The word in Copenhagen is that Mr Fogh Rasmussen is after one of the top posts in Brussels, perhaps as

first holder of the permanent presidency of the European Council that is being created by the European Union reform treaty. The government seems determined not to cause embarrassment at home (or abroad, especially in Britain) by holding a referendum on the treaty. Indeed, Mr Fogh Rasmussen may go a step further, once the treaty is ratified, by holding a referendum to scrap the four opt-outs from EU treaties that were negotiated after the Danes voted no to the Maastricht treaty in June 1992.

Three of these opt-outs—from defence, justice and home affairs, and EU citizenship—are no longer controversial, so a referendum to get rid of them, backed by most political parties, is likely to be won. But the fourth, an opt-out from Europe's single currency, may be harder. The Danes said no to the euro when the issue was put to a vote in 2000. Since then their economy has been one of the best performers in the EU. Denmark enjoys its lowest unemployment rate in 33 years, and is one of the club's richest members.

Yet the Danish krone already shadows the euro. Monetary policy is, in effect, already set in Frankfurt, with the Danes paying a small interest-rate premium merely to keep their own notes and coins. Well-travelled Danes are used to the euro. If Mr Fogh Rasmussen could persuade them to adopt it, making semi-detached Denmark a “normal” full member, his claims to the European Council presidency in mid-2009 would look a good deal stronger.

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Turkey's foreign policy

An eminence grise

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The visionary behind Turkey's newly assertive foreign policy

SHIMON PERES became the first Israeli president to address the parliament of a Muslim country when he spoke to Turkish deputies on November 13th. “We may be saying different prayers, but our eyes are turned toward the same sky and toward the same vision for the Middle East,” he told an audience that included both the Palestinian president, Mahmoud Abbas, and the Turkish one, Abdullah Gul.

For Turkey, this was an historic moment, a chance to reclaim the muscle of its Ottoman forebears as a force in the Middle East. Until a few years ago, Turkey, with its intimate ties with America and Israel, was scorned by its Arab neighbours as a Western stooge. The suppression of public expressions of Muslim piety decreed by Ataturk merely reinforced the canard that Turkey was run by crypto-Jews.

But this image has faded since the mildly Islamist Justice and Development (AK) party came to power five years ago. Even as it pursued the goal of European Union membership, AK started to revive long-dormant ties with the Muslim world. Driving this multi-pronged vision is Ahmet Davutoglu, the self-effacing chief adviser on foreign policy to the prime minister, Recep Tayyip Erdogan.

Disgruntled foreign-ministry officials discount Mr Davutoglu's behind-the-scenes influence, but it is unquestionably huge. Both Mr Erdogan and Mr Gul call him *Hodja*, or teacher. The former academic drew their attention in the mid-1980s with essays on Islam and the West. Ali Babacan, Turkey's young foreign minister, whom Mr Erdogan is rumoured to be grooming as his successor, takes Mr Davutoglu with him wherever he goes.

Critics accuse Mr Davutoglu of pulling away from the West. Never more so than when Turkey invited Hamas's leader, Khaled Meshal, just as Condoleezza Rice, America's secretary of state, was flying to the Middle East to tell Arab governments not to deal with Hamas after its Palestine election win in January 2006. Many see this as the biggest foreign-policy blunder of the Erdogan era. Sitting in his office in the Ottoman sultan's last palace, Dolmabahce, Mr Davutoglu disagrees. Was it not America that exhorted Hamas to take part in the election, he asks. “So why refuse to recognise its results?” Turkey's aim was to persuade Hamas to recognise Israel. Yet the affair had a toxic effect on Turkey's relations with America and Israel.

Born into a merchant family in the conservative city of Konya, Mr Davutoglu is unabashedly pious. He clawed his way into an elite Istanbul lycée, where he was educated in German. Mr Davutoglu rankled at having to read Western classics before touching Turkish ones. Why were Turkey's ideas imported from the West? Where was the great Turkish thinker?

Mr Davutoglu's desire to transform Turkey into a pivotal country in the region lies at the heart of his vision. Turkey was long perceived, he told a conference, “as having strong muscles, a weak stomach, a troubled heart and a mediocre brain.” Getting away from this means creating strong economic ties across Turkey's borders. Even as the Turks threaten separatist PKK rebels inside northern Iraq, business ties with the Iraqi Kurds flourish. Hawks who called for the expulsion of Armenian migrants when an American congressional committee passed a bill calling the mass slaughter of Ottoman Armenians “genocide” were overruled. At the same time Mr Davutoglu is an avid proponent of Turkey's membership of the EU. “Turkey can be European in Europe and eastern in the East, because we are both,” he insists.

The chaos in Iraq and the escalation of PKK attacks remain Turkey's biggest headaches. Yet here too Turkey is taking the initiative. On November 5th it hosted a conference of Iraq's neighbours that was attended by Ms Rice. A day later Mr Davutoglu flew to Washington with Mr Erdogan. He was one of a handful of Turks present at Mr Erdogan's talks with George Bush. Dealing with Turkish foreign policy means dealing with Mr Davutoglu.

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Germany's government

Dropping the co-pilot

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The political consequences of an unpolitical resignation

Get article background

FOR once, the official line had the ring of truth. Franz Müntefering's wife has cancer, so he had compelling personal reasons to resign as labour minister and vice-chancellor of the “grand coalition” on November 13th. Yet politics also played a role, and the decision will have significant political consequences.

Mr Müntefering was a key architect of the coalition between his Social Democratic Party (SPD) and Chancellor Angela Merkel's Christian Democratic Union (CDU), and was widely seen as its stabilising force. He had both the trust of the chancellor and the respect of his party, which feels increasingly disadvantaged as the CDU's junior partner.

Yet he ended up too reform-minded for the SPD and too radical for the CDU. At its party convention last month, the SPD voted for longer unemployment benefits for older workers, which would be a partial rollback of the Agenda 2010 reforms that Mr Müntefering helped to push through in 2003, under the SPD-led government of Gerhard Schröder. Hours before his resignation, in an all-night coalition meeting, Ms Merkel rejected his plea for a minimum wage in the postal service. Mr Müntefering said he was “deeply disappointed”. The SPD accused Ms Merkel of breaking her word and surrendering to the business lobby. Mr Müntefering must have felt let down on all sides.

His resignation leaves the coalition even more bedraggled. The SPD's chairman, Kurt Beck, did not step into his place mainly because he wants the freedom to prepare his party (and himself) for the federal election due by September 2009. The new vice-chancellor, Frank-Walter Steinmeier, is no lightweight—he was Mr Schröder's chief of staff, is Germany's second-most popular politician after Ms Merkel and will remain foreign minister. But he lacks Mr Müntefering's clout within the SPD and has become publicly testy about Ms Merkel's foreign policy. The chancellor is more interested in grabbing headlines by rebuking Russia and China for anti-democratic practices than using quiet diplomacy to discourage them, he has suggested. The two may well clash. Olaf Scholz, promoted from party whip to be labour minister, is a labour lawyer who has none of Mr Müntefering's prestige.

The mix of compromise and stalemate produced by the coalition's late-night tussle may be a foretaste of what is to come. Although it rejected the postal minimum wage, the CDU bowed to the SPD's demand for longer unemployment benefits for older workers. The coalition found enough cash to cut payroll taxes sharply, which should spur job creation. But internal strife has left Deutsche Bahn in limbo. The railway, the federal government's largest enterprise, faced the biggest strike in its history this week. It needs fresh capital, but the SPD refuses to consider raising this by issuing voting shares. It is not clear if it will accept a compromise suggested by the (Social Democratic) finance minister, Peer Steinbrück, under which the tracks would remain federal property but the trains would be partially privatised.

An ambitious government would find plenty to do in its remaining two years in office. It spends €60 billion-80 billion ($85 billion-115 billion) on social-security programmes which pay people not to work. That money could be better spent on education or infrastructure, says Hilmar Schneider of the Institute for the Study of Labour in Bonn. Health-care financing remains a mess. But the coalition is increasingly incapable of rising to such challenges. The risk, as a committee of economic wise men declared recently, is that many of the gains of the past few years may be thrown away.

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A Potsdam story

When east meets west

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A revealing argument about a footpath

THE footpath by the Griebnitzsee, in Potsdam, has seen a lot of history. Kings and kaisers lived around here. Harry Truman ordered the bombing of Hiroshima from a lakeside villa in 1945 while attending the Potsdam conference. His neighbours were Josef Stalin and Winston Churchill (later replaced by Clement Attlee). The Berlin Wall ran along the Griebnitzsee after 1961. The meandering lakeside trails were turned into a corridor for border guards and their dogs. When the wall fell, cyclists and pedestrians took over.

History has not ended quite yet. With German unification, the waterfront mansions acquired rich new occupants, many of them *Wessis* who saw the path as their private property. Last month they escalated a low-intensity conflict with those they deem to be trespassers by barring the way with plastic tape and hiring private security guards, whom the Potsdam police soon removed. The city, backed by most of its 150,000 citizens, wants the footpath to be a public park. That would be an assault on property rights, say the owners. “Maybe some people want to enjoy the footpath,” says Hans Ensing, a Dutch developer who owns one of three houses built by a modernist, Ludwig Mies van der Rohe. “But a larger group wants to enjoy basic human rights.” If need be, he will go to the European human-rights court.

In the early 20th century New Babelsberg, as the area was then known, served as Berlin's version of the Hamptons, populated in summer by a “bankers' train” bearing (often Jewish) financiers and other professionals. After the Nazis expelled the Jews, their homes were taken on in some cases by stars at the Babelsberg film studios. The communists kept up the film connection but stamped out the glamour: a film and television school occupied several villas. Unification brought a new bourgeoisie—and a messy property register.

Heirs of displaced Jews are entitled to reclaim plots right down to the water's edge. Most have sold these to the new owners (Mr Ensing's house was built for a Dresdner Bank director, Georg Mosler). The federal government took over the rest of the buffer strip along the Wall, but some owners bought bits adjoining their plots cheaply. Of 80 owners along the footpath, some 35 now have rights to the water's edge. In exchange for a proper right of way, the city is offering to let them enlarge their gardens and restore the boathouses that once lined the lake. But some ten owners are still at odds with the city.

For some old-timers, this is a reprise of the class war that made communism necessary in the first place. “Thousands of people use this footpath,” says one strolling pensioner, who misses the East German regime. “It's not just for capitalists born with golden spoons in their mouths.” From Mr Ensing's point of view, Potsdam's property grab is the behaviour of a “disguised dictatorship”.

Such polarisation is not the norm in Potsdam. The ex-communist Left Party is the largest on the city council, but the mayor is a *Wessi*. Universities and sexy industries like media and biotech keep the population young and the economy humming. Potsdam is not emptying out like so many other east German cities; its population is growing by 1,000 a year. A recent survey named it the country's child-friendliest city.

As the footpath feud suggests, the cultures of eastern and western Germany may not have melded yet, but the young are more easygoing. Lisa Teichmann, a young lawyer from Brandenburg, suggests there are points on both sides. Mr Ensing has offered, if his rights are upheld, to restore Mies's original wall. But most Potsdamers are tired of walls.

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Charlemagne

A dissertation on Romanian pork

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Illustration by Peter Schrank

Sometimes it is better not to apply the full rigour of European rules

THERE are two reasons why Romanian farmers face an anxious first Christmas in the European Union. One involves a lot of money; the other how to kill pigs. Revealingly, the biggest grumbling is about the pigs.

But first the money. The European Commission is threatening to hold back some €180m ($260m) in farm and rural-aid payments if the Romanian authorities miss a mid-December deadline for setting up anti-fraud controls. So far, ordinary Romanians are not up in arms about this. It helps that most commentators blame the government for the fiasco.

The second threat is more explosive. It involves persistent suggestions that the EU's animal-welfare rules may stop Romanians from slaughtering pigs for Christmas in their backyards. This tradition survived even the dark, kill-joy years of communism. As their first Euro-Christmas approaches, Romanian officials are expressing hopes that the feared Brussels crackdown will not happen. They have warned the commission that messing around with Christmas would be the quickest way to poison Romanians' rather perky attitude to the EU.

The message seems to have been heard: the signs are that Brussels will turn a blind eye to festive law-breaking on a massive scale. In the words of one EU official, “I can hardly foresee infringement procedures against traditional Romanian farmers on this front.” There are so many problems that are “more pressing”, he adds, starting with payment controls to ensure that farm subsidies get into the right hands.

The problem over pigs is simple. Since it joined the EU on January 1st 2007, Romania has been bound by a directive on animal welfare that allows pigs, goats and sheep to be killed at home for personal consumption only if they are stunned with a special device before their throats are cut. That is not going to happen in most backyards. There are some 4.5m farms and smallholdings in Romania. Astonishingly, this country of 22m people has almost a third of all the farm holdings in the EU. Many are run as subsistence farms, with a cow or two, plus horses for ploughing and transport. (The village scenes in “Borat” were filmed not in Kazakhstan but in Romania.)

As the EU expands, its rules have to be applied in situations never imagined when directives were first drafted. Most rich Europeans never meet a pig. But Romanian veterinary chiefs expect as many as 1.5m pigs to be slaughtered in backyards this Christmas. In theory, stunning those pigs is now obligatory. In practice, the government has only just started discussing how it could be achieved. There are doubts about the method most commonly used in abattoirs, involving a powerful electric shock. Use electrodes in

a yard covered with wet snow, and everyone watching risks a shock of their own, explains an official. “And we have a lot of snow in a Romanian winter.” Guns firing captive bolts are now the favoured area for research.

During talks in Brussels last year, the Romanians asked if Christmas pig-killing might enjoy the exemption given to Muslim and Jewish butchers. The commission said no. The directive offers an exemption only for “religious rites”, and Romanian practices are deemed traditional, not ritual. This distinction causes mild offence. Officials in Bucharest say that Christmas pigs are killed around the feast of St Ignatius, on December 20th. They may be sprinkled with holy water. Adults watching the slaughter will traditionally be fasting, and will not eat the festive dishes derived from the pig (jellied bits of head, pork cabbage rolls with polenta, blood sausages and so on) until Christmas Eve. Some village schools give pupils the day off for the pig killing, and children are fed singed bits of skin to cheer them up. “The children will cry for the pig, because it has been their friend for a year,” admits Niculae Lazar, a government vet. But backyard pigs lead better lives than industrial farm animals, he adds.

Over time, the trend is clearly towards more professional pig killing. City-dwellers visiting grandparents in the country are more squeamish than their country cousins, and they also worry about trichinosis, a nasty parasitic disease that can infect backyard pigs. One idea is to see if vets hired to carry out trichinosis tests might throw in pig-stunning free. But this would take time. “We are trying to find a balance between our traditions and our European obligations,” explains Radu Roatis, Romania's veterinary boss.

Modernise with care

Membership of the EU will not be plain sailing for Romanian farmers. The club remains sternly inflexible in many areas. As soon as farm produce is sold commercially, the full panoply of food-safety and hygiene rules apply, even for cheese that never leaves the village. Eurocrats say such toughness is needed to maintain public support for enlargement in countries of longer-standing membership. In ultra-sanitary corners of Europe, consumers are fussy about what they eat and feed their children. Heeding the fears of such people is part of the price of admitting countries such as Romania to the single market.

On the edge of Bucharest, in the scruffy village of Jilava, Dumitru Dumitrescu has little time for the EU's animal-welfare rules. With or without stunning, the death of a pig “goes pretty quick”, he says, as he shows off the sow he is fattening up for Christmas. But the 78-year-old is all for other rules on food safety. “Romanian peasants use too many pesticides. It's not controlled properly, so it gets into the milk.”

In other words, Romanians are consumers too. That makes them potential allies. When it comes to catching up with European norms, the list of Romania's gaps is long and serious. Public support will be needed to tackle many of these: from rampant corruption to border-hopping diseases such as bird flu. If Eurocrats can keep that support by leaving Christmas traditions alone, that should not make anyone else anxious.

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Economic troubles

When the credit dries up

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Illustration by David Simonds

Growth will wilt next year, prompting lower interest rates

Get article background

THREE months ago, when the Bank of England set out its quarterly outlook, the economic weather looked benign, the barometer set fair. The *Inflation Report* showed that the current pace of growth was too strong for comfort but that it would moderate nicely in 2008. Inflation would stay under control over the next couple of years provided that the base rate rose from 5.75% to 6.0% by early 2008.

That was on August 8th. The following day the world's financial markets froze and the credit crisis began. Since then Britain's central bank and Mervyn King, its governor, have rarely been out of the news. First Mr King adopted a controversially stern line in August, standing aside from the emergency injections of funds into the money markets made by America's Federal Reserve and the European Central Bank. Then the revelation in mid-September that the Bank of England was stepping in as lender of last resort to Northern Rock, a fast-growing mortgage lender that had run out of ready cash, precipitated the first bank run in Britain since Victorian times.

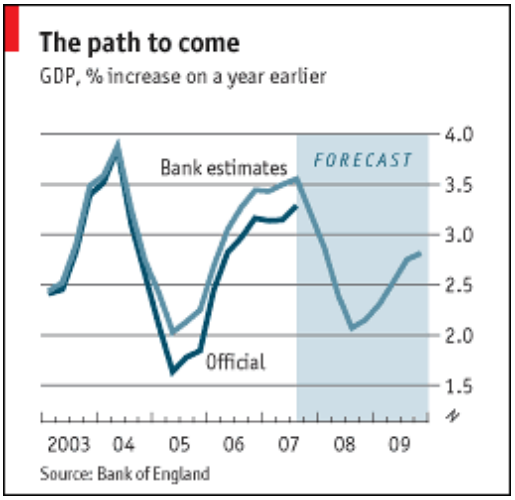
Throughout this period Mr King and his fellow rate-setters on the monetary-policy committee have held the base rate at 5.75%, the level it reached in July, up from 4.5% a year before. But on November 14th, in its latest *Inflation Report*, the central bank signalled that the rate will come down, as the markets have been expecting, to 5.25% next year; and that a further quarter-point reduction is quite likely in 2009.

The relief may be welcome but the reason is less encouraging. The central bank has thought long and hard about the economic impact of the credit crunch and has concluded that it will be painful. The latest official figures show that the economy grew by 3.3% in the year to the third quarter. The bank thinks this will turn out after revisions to have been too low, and estimates that GDP actually rose by 3.6%.

That will prove to be the high point of the current cycle, however. The report's central projection, which takes into account interest-rate cuts already expected by the markets, is that economic growth over the next year will fall back to around 2% (see chart). In August, by contrast, the bank forecast a much softer landing, with growth gently slackening to 2.6% over the same period.

The financial crisis of the past three months is the main reason

why economic prospects have taken a turn for the worse. Banks are now less gung-ho about lending both to individuals and to firms. And they are charging more for their loans, especially to riskier customers.



This credit squeeze will feed through to slower growth in three main areas, according to Charles Bean, the Bank of England's chief economist. Business investment, which has been particularly buoyant over the past 18 months, will lose some of its pep. In particular, commercial-property developments will be curtailed and small businesses will find it harder to get loans. Investment in residential housing will decline. And as consumers—the mainstay of demand over the past decade—save more, household-spending growth will become more muted, falling below its average rate over the past ten years.

Adding to the economic misery, inflation looks set to stage a minor comeback over the next year. After staying below the government's 2.0% target for three months, consumer-price inflation rose from 1.8% in the year to September to 2.1% in October. The broader retail-price measure rose from 3.9% to 4.2%. Food and petrol were the main culprits, only partially offset by falling gas and electricity prices.

The bank's central projection for inflation shows it rising a bit further next year. The increase is too small to warrant the term stagflation, which plagued Western economies in the 1970s, but it will add to the pressure on household budgets next year. Inflation then falls back to the target in 2009, which is why the report indirectly indicates that cuts in interest rates are on the way: the forecast, like the one for growth, is based on market expectations. Indeed, if the base rate were held unchanged at 5.75%, inflation would fall to around 1.75% in two years' time.

The Bank of England's prognostications may seem quite gloomy enough. But the worrying thing is that it thinks things are likelier than not to turn out worse; in central-bankese, “the risks to growth are on the downside”. Presenting the report, Mr King said that “further tightening of credit conditions and disturbances in financial markets pose the biggest downside risk to the outlook.”

Even so, the central bank may still be underestimating the possible scale of the downturn. For one thing, it thinks that global growth will slow fairly modestly as developing economies continue to expand rapidly. This forecast would prove too sanguine if America were to slip into recession, as seems increasingly likely.

Closer to home, the Bank of England is not expecting a pronounced downturn in the housing market. Yet a report this week from the Royal Institution of Chartered Surveyors painted a grim picture of falling house prices, lower inquiries from new buyers and rising stocks of property on estate agents' books. If the housing market does turn down decisively, consumer-spending growth is likely to be a lot weaker than the central bank expects.

The economy has proved its resilience in recent years. But it has also been awash with cheap credit. As that dries up, a serious reverse looks more likely than at any time in the past decade.

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Gordon Brown's foreign policy

Taking shape

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The prime minister's developing view of the world

Gordon Brown

IT IS hard to guess which discomfited Gordon Brown more about his Mansion House speech on November 12th—his formal attire (as chancellor, he eschewed white tie and tails for a lounge suit) or the subject of his address. Foreign affairs, the traditional theme of this annual speech by the prime minister, stirs Mr Brown less than it did his predecessor. Indeed, it was his first big pronouncement on the matter since he replaced Tony Blair in June.

And it was not without its successes. For one, it reaffirmed Mr Brown's Atlanticist credentials at a time when many were wondering whether his vaunted affinity with America extends much beyond East Coast intellectuals of a liberal bent. After the jibes aimed at Mr Blair—George Bush's "poodle"—there was political advantage in putting distance between himself and the president. He was visibly cool towards Mr Bush on his visit to Camp David in July. His international-development secretary, Douglas Alexander, criticised America in a speech the same month. Lord Malloch Brown, a Foreign Office minister, is a longstanding foe of the Bush White House.

But by declaring that America remains Britain's "most important bilateral relationship", Mr Brown seemed to acknowledge that he could not count on Washington to forgive all this as harmless posturing for a domestic audience. This is especially true now that America no longer wants for other European allies. Nicolas Sarkozy, the French president, and Angela Merkel, the German chancellor, are keen to improve their countries' relations with America.

The speech also showed that Mr Brown's view of international relations is not narrowly economic. He continues to set great store by development aid to further policy but he has thoughts as well on preventing the spread of nuclear weapons and reforming international institutions. Rather than skirt the issue of Iran on the assumption that Mr Bush's successor will be much more doveish, Mr Brown threatened tougher sanctions against Tehran.

Still, the prime minister could have elaborated on some topics. He said little about Afghanistan, where Britain is likely to remain for years to come. Those who urged him to use this opportunity to be honest about the scale of the commitment required were disappointed.

His remarks on Europe were also sparse. Whereas Mr Blair championed causes within the European Union such as enlargement and economic reform, Mr Brown says only that it should be more outward-looking. Yet problems such as the EU's lack of democratic accountability (acutely felt by the British, who dislike the reform treaty that Mr Brown aims to ratify without a referendum) won't solve themselves. And he declined to elucidate his position on Turkish membership of the EU.

The prime minister's reticence on foreign affairs does have advantages. Mr Blair came to be resented for his jet-setting; Mr Brown's focus on bread-and-butter issues at home will please voters. It also allows him to rebut the notion that he is not a team player. Mr Blair was effectively his own foreign secretary, more so than any prime minister since Winston Churchill, whereas Mr Brown is happy to delegate to David Miliband. And though Mr Blair had bolder ideas on foreign policy (such as the liberal interventionism he espoused in his Chicago speech of 1999), they contributed to his downfall. Mr Brown's "hard-headed internationalism", which calls for greater reliance on reformed multilateral bodies, is hardly inspirational, but it is prudent.

Yet Britain may come to miss the high profile that Mr Blair's hyperactivity gave it. He was Europe's most visible leader on the world stage. Mr Brown, by contrast, is somewhat in the shadow of Ms Merkel and Mr Sarkozy. "Sarkozy has Blair's dynamism," says Michael Williams of the Royal United Services Institute, a research body, who was in Washington this week to explain the prime minister to the Americans. "Brown

is a different character.”

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Northern Ireland

Troubled waters

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Violence threatens, but less than before

Get article background

ULSTER'S miserable past refuses to go quietly. Two policemen were shot and injured by republican paramilitaries in the five days from November 8th. On November 11th the Ulster Defence Association (UDA), the largest of the loyalist paramilitary groups, said it would “stand down” from midnight but would neither destroy nor hand over its weapons. The following day the peace-process watchdog, the Independent Monitoring Commission (IMC), confirmed that those who beat Paul Quinn to death last month across the border from south Armagh were IRA members “past or present, or associates”. It was too soon to tell, it said, whether the IRA's commanding “army council” had given the order.

These events make many anxious. Others, however, note advances. The policemen were shot by men who call themselves the Real IRA, an implicit dismissal of mainstream republicans who support the peace process that six months ago put Martin McGuinness, a former IRA leader, at the head of the province's devolved government along with the Rev Ian Paisley, once a diehard unionist.

Twenty years ago Mr McGuinness directed the bombings that blitzed the centre of Londonderry. This time he derided those who attacked an officer in that city for seeming not to know the war was over, and called on witnesses to help the police. Mr Paisley and his troops have changed as well. In the past his Democratic Unionist Party professed to see no difference between mainstream and dissident republicans. This week he was content to seek assurances from Sir Hugh Orde, chief constable of the Police Service of Northern Ireland (PSNI), that the police had resources enough to “quash” the dissidents.

Not everything has changed, of course. As often in the past, the injured policemen were soft targets. One, in Dungannon, was shot as his car was stalled in a traffic jam. The Londonderry officer was wounded as he dropped off his son at school. A friend said he had recently joined the PSNI, which is 23% Catholic, because he believed it very different from the old Protestant-dominated Royal Ulster Constabulary. (He had, however, moved house.) The Real IRA answered Sinn Fein's pleas for co-operation with the police by threatening to kill anyone who did so. And the shooting in Dungannon caused a long-delayed meeting of the policing-partnership committee there, to which Sinn Fein had at last sent nominees, to be cancelled.

But violence is yielding diminishing returns. The Real IRA became notorious in 1998, when they tried to wreck the newly negotiated power-sharing settlement by bombing the town of Omagh, near Dungannon. The death toll of 29 was the greatest loss of life in a single Troubles bombing. But the tragedy strengthened support for the peace process. Most dissident attacks since then have been sabotaged by police infiltration and what many suspect is information from other republicans.

There is no loyalist equivalent of Sinn Fein, originally the IRA's mouthpiece and now the largest party representing Catholic voters. The UDA and the smaller Ulster Volunteer Force came into being to defend the Union and Protestants against the IRA, though most of their 980 victims were innocent Catholics. As IRA violence waned, UDA figures became best known for their drug-dealing, gold jewellery and cocaine habits. Fledgling loyalist politics were damaged by association. Rivalry for the control of lucrative criminal businesses fuelled violent feuds and delayed the decommissioning of weapons.

Loyalist groups first called a much-breached ceasefire in 1994, and the UDA's announcement this time was undermined by the refusal to hand over its guns. But a recent tragedy has underlined just why the paramilitaries must be put out of business. A fortnight ago a 16-year-old named Dean Clarke hanged himself in the down-at-heel Tigers Bay district of north Belfast. He had just come out of hospital after treatment for drug poisoning. His mother said a local UDA boss had sold the boy ketamine, a tranquilliser used to sedate horses.

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Bird flu

Stalking the land

Nov 15th 2007
From The Economist print edition

Another outbreak brings more culling of Britain's unhappy farm animals

Get article background

IF MISERY loves company, Britain's embattled livestock farmers must be over the moon. On November 12th William and Geoffrey Buchanan, poultry farmers in Suffolk, joined a growing band whose animals have been put down in recent months because they had contagious diseases. On November 13th government vets said that their free-range turkeys which had died at the weekend had tested positive for the virulent H5N1 strain of bird flu. All 6,500 birds on the farm have now been slaughtered. Birds at four nearby farms were culled too.

It is the second outbreak of this particular disease in Britain; in February H5N1 was contained only after the slaughter of 160,000 fowl at a large Suffolk farm. Then in July came foot-and-mouth, a highly contagious virus that affects cows, sheep and pigs. It flared up again in September, despite a 2,000-strong cull and nationwide restrictions on moving farm animals. And just a few days later, bluetongue, a disease of ruminants that is spread by midges, made its first British appearance.

The latest blow came just as government vets could have hoped to draw breath and start making long-term battle plans. Foot-and-mouth seems to have been halted by a speedy official response, and EU restrictions on imports from Britain have been eased ahead of schedule. Bluetongue is quiescent over the winter, when it is too cold for midges. Officials are waiting to see whether the recent outbreak was caused by a few midges blown over from the continent or whether it has become endemic, in which case it will reappear in spring. In the meantime scientists are working to create a vaccine against it. On November 1st the farming ministry announced a tender for 10m-20m doses.

Despite their near-simultaneous arrival in Britain, the three diseases came by different routes and call for different approaches. Foot-and-mouth was accidentally released from a laboratory, and was tackled by culling and restricting animal movements. Neither measure can be deployed against the midges that spread bluetongue, so a vaccine is probably the only hope.

Bird flu is different again: like bovine TB, another plague, it is hard for humans to catch but serious when they do. Again like TB, it is harboured by wild animals. Badgers are routinely culled in the hope of protecting cattle from TB, but the wild birds who visit the farm with bird flu cannot be slaughtered so easily. If they carry the disease, no quantity of slain turkeys will curb it. Christmas dinner may be scanty for years to come.

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Scottish budget

A MacTax haven in the making?

Nov 15th 2007 | EDINBURGH
From The Economist print edition

Alex Salmond is light on the spending pledges but heavy on popular tax cuts

Get article background

TO ENVIOUS eyes south of the border, Scots get an awfully good deal. Devolution and generous handouts from the British taxpayer mean that Scots have free eye and dental check-ups, free personal care for the old and no university-tuition fees for the young. On November 14th, when the Nationalist government unveiled its spending plans for the next three years, Alex Salmond, Scotland's first minister, showed he had another wheeze for driving jealousy levels higher—lower taxes.

The budget for 2008-11 does contain a few more goodies for Scottish voters, such as the abolition of prescription charges by 2011. But the tight financial settlement imposed by Britain's Treasury last month—a 1.4% increase in Scotland's block grant over three years—means that Mr Salmond has had to trim back his ambitions. Pledges to cut class sizes to 18 pupils in the first three years of primary school have been turned into an “aim”, and the 1,000 new policemen he promised have shrunk to 500.

Mr Salmond's calculation is that voters may forgive him these lapses if he cuts their taxes. By raising the amount he is giving local councils from £10.6 billion in 2007-08 to £12 billion in 2010-11, he reckons councils will be able to freeze council-tax bills for the next three years. They are likely to toe his line, for other concessions he is giving them, such as more freedom over how they spend their budgets, depend on their accepting the tax standstill. This may please Scottish voters, but it will further irk opinion south of the border, where steeply rising council-tax bills are a hot political issue. In Scotland such taxes are now about 10% lower than in England and this move will widen the difference.

Mr Salmond's tax-cutting agenda does not stop there. He is also promising to spend about £120m a year on cutting local taxes for around 150,000 small businesses. This is not just to annoy his southern neighbours. On November 13th Mr Salmond published a national economic strategy with the immediate target of boosting Scotland's economic growth to match British growth rates by 2011. Since Scottish GDP grew at an average 1.8% a year between 1975 and 2005, compared with Britain's 2.3%, this looks a tall order.

Mr Salmond expects, with some insouciance, that Scotland will be independent by 2017. He wants his country to equal the economic performance of its small neighbours—Ireland, Iceland, Norway, Denmark and Finland—whose long-term growth rates range from 2.5% and 5.0%. The key ingredients for economic success, he thinks, are boosting skills (which is why he wants university education to be free) and concentrating on Scotland's competitive advantages. Both require getting Scotland's hands on the full fiscal toolkit. If Scottish taxes are lower than those in the rest of Britain, that would be an advantage.

Lower property and local business taxes are a start. Mr Salmond's big test will come in 2010, when he hopes to abolish council tax completely and replace it with a local income tax levied at a flat rate of 3p in each pound of basic-rate national income tax due. His big problem is that council tax now raises about £1.7 billion and his income-tax plan will raise only £1.2 billion. Although Scotland's grant is due to rise to £35.7 billion by 2010-11, finding the extra £500m will still be a headache. In the meantime, however, he is giving Scottish voters plenty of reasons to be cheerful.

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Northern Rock

Overexposed

Nov 15th 2007
From The Economist print edition

Shareholders of the stricken bank are flexing their muscles

LIGHTS burned late into the night at investment banks across London this week as a coterie of private-equity buyers and bankers prepared to battle over the bones of Northern Rock, the stricken mortgage lender. Yet for all the bankers' feverish excitement, hearts are sinking at the Treasury and the Bank of England. It seems increasingly likely that there will be no quick return of the more than £23 billion of taxpayers' money that has been lent to the bank since it was granted emergency support on September 14th.

Just how deep a hole the government has been shovelling cash into was revealed—and then partly concealed—on November 13th, when the *Financial Times* published on its website excerpts from confidential sale documents that had been sent to potential bidders. These included an assumption by Northern Rock's advisers that the bank might still owe the taxpayer some £6 billion in 2010, and that the money might be used, in some scenarios, to finance Northern Rock's riskiest assets.

Although further details were also revealed, including estimates of the bank's future profitability, lending and borrowing, most of these cannot be published. A late-night court case brought by Northern Rock forced the *Financial Times* to pull the pages from its website—but not before they were widely seen and copied to servers in other countries—and ordered newspapers, including this one, not to publish much of the information they contained.

Revealing as the document was, it may already be outdated. This is because the view that prevailed when it was drawn up was that money was to be returned to taxpayers as soon as possible. If that meant Northern Rock's owners lost everything, it would be a fitting punishment for the bank's imprudence. Although a case could be made for using public money to save the bank, rescuing private investors was not part of it. This is one reason why the Bank of England insisted on charging Northern Rock a punitive rate of interest on its loan, thought to be about 7%. But it is steadily eating into the value of the bank with each passing day.

Now officials in the Treasury and the central bank are beginning to realise that a tidy solution will probably need the support of the ailing mortgage lender's shareholders, because getting them to swallow the bitter pill originally prescribed may prove impossible. The emergency loan is the main instrument the government has to bend Northern Rock to its will. It could, at a stroke, push the bank into insolvency by cutting off its supply of money, forcing it into administration and selling its assets to repay creditors, including the taxpayer. But few believe that the government will decide to pull the plug, so shareholders are left with a deciding vote on any restructuring or sale.

There are three reasons for the government's reluctance. Pushing the bank into insolvency would be a political embarrassment: having risked billions of pounds trying to prop it up, the government would look shamefully incompetent if Northern Rock then collapsed. It would also underline the harm that the whole sorry saga has done to London's standing as an international financial centre, perhaps diverting some business elsewhere. And it might well trigger an automatic winding-up of Granite, the vehicle that Northern Rock used to securitise mortgages, which provided a cheap source of funding for many of its loans. That could reduce the value of the bank substantially and tie up some of its capital for years to come, increasing the risk that taxpayers might lose money on their loan to Northern Rock.

“The only weapon the government has is a nuclear one,” says one person involved in the talks. “There are no conventional weapons in its armoury.” Calling the government's bluff, however, are hedge funds such as SRM and RAB, which have recently increased their stakes in Northern Rock. They were joined this week by Luqman Arnold, who rescued and then sold Abbey National, a large British mortgage lender that was brought to its knees a few years back by ill-considered investments. He has audaciously proposed a turnaround of Northern Rock, rather than a sale, and wants to put in his own team of managers in exchange for buying a minority stake. The surprise is not that shareholders are willing to give him a

sympathetic hearing, but that the government may be too.

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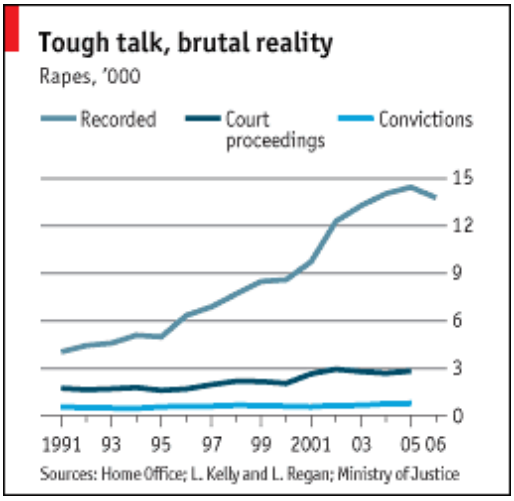
Tackling rape

Slow progress

Nov 15th 2007
From The Economist print edition

Britain's record is not as bad as Tories claim, but improving it will be hard

Get article background



THE snowy-white heads of the Conservative Women's Organisation nodded vigorously. David Cameron, the party's young leader, was in serious mode. Britain's record on rape, he said on November 12th, betrayed a "moral collapse". Of all the rapes reported in England and Wales last year, just 5.7% resulted in a conviction—down from 33% in 1977. Britain has the lowest conviction rate of any big European country, he added. For this age-old crime, Mr Cameron had an equally ancient solution: longer prison sentences.

Conviction rates are a bad way to monitor success in tackling rape. Since they depend on both the number of reported crimes and the number of perpetrators found guilty, tumbling conviction rates can mean either that fewer people are being convicted or that the police are being told of more crimes. In Britain it is due to the latter (see chart).

Mr Cameron's comparison with other countries is especially misleading. Britain's conviction rate for rape is indeed Europe's joint-lowest, with Sweden's. In Portugal, by contrast, 14% of reported rapes result in convictions. But Portugal convicts only a third as many rapists per person as Britain; its conviction rate looks good only because it records a sixth as many incidents per person. Surveys suggest that the number of attacks in Britain stayed stable throughout the 1990s, even as the number of reported crimes rose dramatically. More reporting seems to reflect victims' growing confidence rather than more assaults.

Where Britain falls down, however, is in bringing suspects to court. A report in January by the Crown Prosecution Service examined why this was so. Of all reports made to the police, 24% did not meet the criteria to be formally recorded (eg, the alleged rape was committed outside the force's jurisdiction, or the complaint was made by a friend who was poorly informed). About 14% of those that were recorded stalled because the attacker could not be identified—a smallish proportion, since most rapists attack acquaintances—and 18% were ditched because the victim withdrew the accusation. Some 40% were dropped due to lack of evidence.

Some of these gaps should be easier to plug than others. The report found that nearly a third of the cases labelled "no crime" by police should have been taken further. More rape-counselling centres might persuade more victims to pursue their cases. Mr Cameron pointed out that, whereas 68 such centres existed in 1984, only 45 do now, though the government is building more.

But lack of convincing evidence is the most frequent reason why cases are abandoned, and this is the hardest thing to remedy. Better use of forensic tests might help in a few cases, as they did triumphantly on November 12th, when a 1975 murder was solved by using new DNA-matching techniques. But the toughest cases rest on the near-unprovable question of consent, made harder still by an upsurge in youthful boozing. Tory plans for longer sentences would do nothing to deal with this problem—and could even make cautious juries lean more towards acquittal. Average sentences for rape have in any event already doubled since 1984.

Women's groups backed Mr Cameron's call to change sex education in schools so that boys learn that no means no and girls that they can insist on the right to refuse. Only 60% of women subjected to forced sex are willing to call it rape, according to the British Crime Survey, so no wonder three-quarters of attacks go unreported.

Sex and violence in music and the media are partly to blame for a climate conducive to rape, said Mr Cameron, before walking out to the sound of The Killers. His party has a long way to go. But there may be scope for a modern kind of conservatism on sex education. Ten years ago, Tories who said sex lessons should not be “values-free” were usually taking a swipe at homosexuals. If he can lead his white-headed army into battle against violent men instead of gay ones, Mr Cameron will have done everyone a favour.

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Economist.com WORLD INTERNATIONAL

Russia and the West

Out to do business, or out for a scrap?

Nov 15th 2007
From The Economist print edition

Illustration by David Simonds

Under Vladimir Putin, Russia is once again flexing muscles and scoring diplomatic points—but it is not always clear what purpose this serves

Get article background

ACROSS a broad, cold front of disagreements—over Kosovo, the expansion of NATO, the durability of arms-control agreements, America's plans for new missile defences in Europe, how to cope with the nuclear ambitions of Iran, and Russia's steely grip on energy supplies to parts of Europe—Russia and the West have not seemed so much at odds in a decade. President Vladimir Putin has likened America to Hitler's Third Reich and compared missile defences for Europe to the 1962 Cuban missile crisis. Is it now enduring winter in relations with Russia?

That rather depends on what exactly Mr Putin intends with his recent tough talk. Is it based on a realistic view of Russia's strengths and interests, and is the ultimate aim to solve problems, or to create them? Like any other country, Russia has interests to defend. Common threats from terrorism, proliferation and the like mean that its interests don't always differ much from those of America and Europe. But at times, Mr Putin seems bent on proving only that Russia is again able to say *nyet*.

Take the Balkans. In mid-December, efforts to negotiate the peaceful separation of Kosovo from Serbia are likely to run out of road. Regional stability could be jeopardised, with Russia backing the rejectionist Serbs and America and the European Union with varying degrees of enthusiasm supporting the Kosovars.

Although the place has been under UN administration for eight years, Russia has argued that a self-declared independent Kosovo will prompt other breakaway regions, such as Abkhazia in Georgia and Transdniestria in Moldova (where Russia still has some troops) to follow suit. Yet Russia's public support for the Serbs also masks differences with them: a recent 14-point proposal from the troika of the EU, Russia and America to break the deadlock included several Russian ideas, but it was rejected flatly by the Serbs. One key question now is whether Russia will help or hinder efforts to prevent flare-ups between extremist Serbs and Kosovars.

Meanwhile Russia's Duma, the lower house of parliament, has voted unanimously to back a moratorium from December 12th on Russia's obligations under the Conventional Forces in Europe (CFE) treaty. The move would leave Russia free to shift troops and arms to its western borders, unrestrained by the ceilings and transparency rules that have been a cornerstone of European security for 15 years. Mr Putin has long complained that the amended 1999 version of the CFE treaty, updating the 1992 original to take

account of the Soviet break-up, has not been ratified by NATO countries, and that Estonia, Latvia and Lithuania have yet to sign on.

NATO governments say that is because Russia has not kept related pledges to pull all soldiers out of Abkhazia and Transdniestria (where their jobs include guarding a huge ex-Soviet weapons dump). But taking Mr Putin at his worried word, last month America proposed a series of parallel steps: some NATO governments would start CFE ratification, the Balts would prepare to join the treaty and Russia would also move to fulfil its promises, with new arrangements for Transdniestria's weapons. Now Russia is raising new demands that could scupper the whole treaty. Some wonder if that was Mr Putin's real aim.

On some issues, Russia gets more sympathy—for example, when it balks at the Bush administration's insistence that, since the two are no longer foes, intrusive verification rules governing their shrinking strategic arsenals can be relaxed after the existing ones expire in 2009. Richard Lugar, an influential Republican senator, favours a new legally-binding understanding to avoid sowing what he calls “seeds of greater distrust” with Russia.

Worries about Russia in America and in Europe have led administration officials to seek new ways to work with Mr Putin where they can. America and Russia have called jointly for other states to accept the curbs imposed by their bilateral treaty on Intermediate-range Nuclear Forces. The 1987 treaty bans both from deploying missiles with ranges of 500-5,000km. North Korea and Iran, but also Israel, India, Pakistan and China field such missiles.

However Mr Putin's declared fear of such weapons being set up near Russia's borders seems at odds with his dogged lack of understanding for a pet American project: missile defences for Europe.

The plan to put a missile-defence radar in the Czech Republic and a small number of interceptors in Poland, to deal with an emerging threat from Iran, at first sent Mr Putin ballistic. But Russia's threats to target the two sites with its own nuclear missiles backfired. Mr Putin later offered two radar sites, one in Azerbaijan and another in Russia, instead of the Czech and Polish facilities. Last month America made Mr Putin an unprecedented counter-offer: to link Russia's radars with the American-led project and NATO's shorter-range defences so as to improve the coverage of both Europe and European Russia. To allay Russia's other concern—that Europe-based missile defences could someday undermine Russia's strategic deterrent (a claim some Russian officials privately call far-fetched)—America's secretary of defence, Robert Gates, says the system, even when built, would become operable only if the presumed threat from Iran materialises.

In fact, missile defences against Iran “ought to be the centrepiece” of strategic co-operation, argues a senior Bush administration official. Mr Putin has said he will think about it; his generals seem unimpressed. Instead, at a time when Russia's defence budget is a fraction of what it was in the cold war, they prefer to resurrect Russia's ageing bomber-fleet to fly ineffectual sorties against the West—just as Mr Putin has lately resorted to verbal offence as a form of defence. The idea seems to be to show that “Russia is back”. But it is not back making friends, and on some issues at least, it still needs them.

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Economist.com WORLD INTERNATIONAL

University rankings

Measuring mortarboards

Nov 15th 2007
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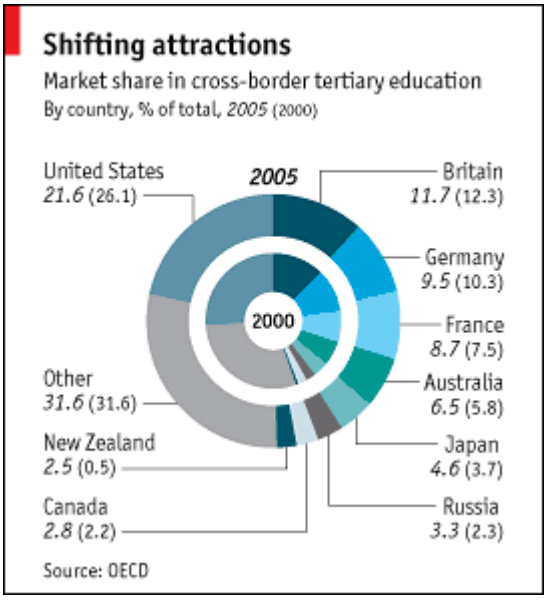
A new sort of higher education guide for very discerning customers

WORKING out exactly what students and taxpayers get for the money they spend on universities is a tricky business. Now the Organisation for Economic Co-operation and Development (OECD), a Paris-based think-tank for rich countries, is planning to make the task a bit easier, by producing the first international comparison of how successfully universities teach.



That marks a breakthrough. At the moment, just two institutions make annual attempts to compare universities round the world. Shanghai's Jiao Tong University has been doing it since 2003, and the *Times Higher Education Supplement*, a British weekly, started a similar exercise in 2004. But both these indices, which are closely watched by participants in a fickle and fast-expanding global education market (see chart), reflect "inputs" such as the number and quality of staff, as well as how many prizes they win and how many articles they publish. The new idea is to look at the end result—how much knowledge is really being imparted.

"Rather than assuming that because a university spends more it must be better, or using other proxy measures for quality, we will look at learning outcomes," explains Andreas Schleicher, the OECD's head of education research. Just as the OECD assesses primary and secondary education by testing randomly chosen groups of youngsters from each country in reading and mathematics, it will sample university students to see what they have learned. Once enough universities are taking part, it may publish league tables showing where each country stands, just as it now does for compulsory education. That may produce a fairer assessment than the two established rankings, though the British one does try to broaden its inquiry by taking opinions from academics and employers.

There is much to be said for the OECD's approach. Of course a Nobel laureate's view on where to study may be worth hearing, but dons may be so busy writing and researching that they spend little or no time teaching—a big weakness at America's famous universities. And changes in methodology can bring startling shifts. The high-flying London School of Economics, for example, tumbled from 17th to 59th in the British rankings published last week, primarily because it got less credit than in previous years for the impressive number of foreign students it had managed to attract.

The OECD plan awaits approval from an education ministers' meeting in January. The first rankings are planned by 2010. They will be of interest not just as a guide for shoppers in the global market, but also as indicators of performance in domestic markets. They will help academics wondering whether to stay put or switch jobs, students choosing where to spend their time and money, and ambitious university bosses who want a sharper competitive edge for their institution.

The task the OECD has set itself is formidable. In many subjects, such as literature and history, the syllabus varies hugely from one country, and even one campus, to another. But OECD researchers think that problem can be overcome by concentrating on the transferable skills that employers value, such as critical thinking and analysis, and testing subject knowledge only in fields like economics and engineering, with a big common core.

Moreover, says Mr Schleicher, it is a job worth doing. Today's rankings, he believes, do not help governments assess whether they get a return on the money they give universities to teach their undergraduates. Students overlook second-rank institutions in favour of big names, even though the less grand may be better at teaching. Worst of all, ranking by reputation allows famous places to coast along,

while making life hard for feisty upstarts. “We will not be reflecting a university's history,” says Mr Schleicher, “but asking: what is a global employer looking for?” A fair question, even if not every single student's destiny is to work for a multinational firm.

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Coal power

Still going strong

Nov 15th 2007
From The Economist print edition

Corbis

Efforts to curb greenhouse-gas emissions have yet to dent enthusiasm for coal

NO UTILITY with any respect for its shareholders' money, says Michael Morris, the boss of the biggest one in America, AEP, would build a heavily polluting coal-burning power station in America these days, for fear that it would become a liability if the government moved to limit emissions of greenhouse gases. Europe already has a cap on emissions, which is designed precisely to discourage dirty fuels such as coal. So why is it that utilities in both places are running their coal-fired plants at full throttle, have several new ones under construction and would like to build even more?

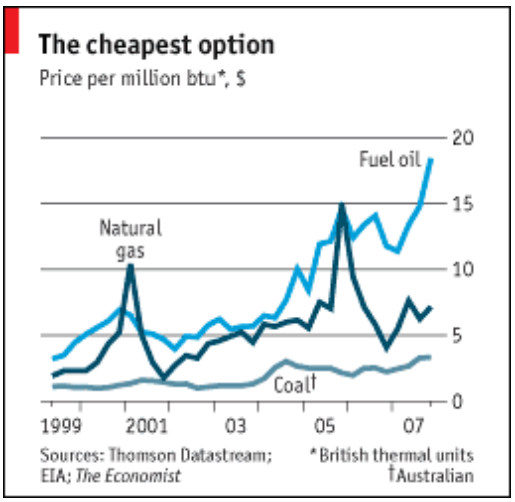
Using coal to generate electricity produces more greenhouse gases per resulting watt than using oil or natural gas, but coal is cheap. In countries where there are no limits on emissions and where demand for power is growing rapidly, such as India and China, coal is booming. Energy lore has it that in China a new coal-burning plant is fired up every week. What is certain is that China has become a net importer of coal for the first time this year. India's imports have been growing steadily for the past 20 years. The International Energy Agency, an energy watchdog for rich countries, projects that demand for coal will grow by 2.2% a year until 2030—faster than demand for oil or natural gas. Coal-mining firms in Indonesia and Australia, the biggest exporters, are digging as fast as they can but are still struggling to cope with the surge in orders. Freighters are literally queuing up off Newcastle, Australia, the world's busiest coal port.

But poor and fast-growing places are not the only ones with a hunger for coal. In America, more coal-fired generation is being built than at any time in the past seven years, despite the threat of emissions caps, according to the Department of Energy. In Europe, several power companies are building new coal-fired plants, even though every tonne of carbon dioxide that they emit will require an expensive permit. For example, RWE, a German utility, plans to spend €6.2 billion ($9.1 billion) on three new coal-fired plants by 2012. One of them is already under construction.

All this has helped to push the price of coal steadily upwards in the past few years. Nonetheless, it has risen less quickly than that of oil or natural gas. Coal is now by far the cheapest of the common fuels for power stations relative to the amount of heat it generates when burnt (see chart). At the very least that is encouraging utilities to run their existing coal-fired plants flat out. But it is also prompting some to convert oil-fired plants to run on coal instead. Enel, Italy's former electricity monopoly, has already performed one such refurbishment, and has two more under way, at a cost of €3.8 billion. Leonardo Arrighi, who supervises the firm's investments in generation, says it would like to build “more and more” coal-fired plants.

In theory, the carbon price (in Europe) and the threat of one (in America) should dent this enthusiasm for coal. But in practice many utilities are betting that the disparity in fuel prices will outweigh the cost of extra permits to pollute. At the moment such

permits cost pennies in Europe, because governments handed out too many of them. Although there should be more of a shortage starting next year, the futures price would have to rise from the current €22 per tonne of carbon to over €30 per tonne to prompt a significant switch away from coal over the next two years, according to Henrik Hasselknippe of Point Carbon, a consultancy.



To be fair, many of the coal-fired power stations under construction in Europe and America are very efficient, and so emit less carbon per watt of output than existing plants. RWE and Enel both claim that their new plants will be among the most efficient in Europe. AEP is building a similar plant in America, which will remain profitable at carbon prices of up to $20 a tonne, according to Mr Morris. Meanwhile, many American firms are cancelling or delaying plans to build grubbier coal-fired plants until they have a clearer idea of future carbon prices.

Politicians in both Europe and America talk of carbon prices eventually being so high that coal-fired plants will be viable only if they capture their emissions and store them underground. But no such plants yet exist. Most of those under construction are not even “capture-ready”, as the industry jargon has it, since utilities do not consider the extra expense worthwhile. Even in Europe, with its steadily tightening emissions cap, much higher carbon prices or stricter regulation will be required to get utilities to build capture-ready plants, says John Krenicki, the head of the energy division at General Electric.

In fact, governments are sending out conflicting signals. Germany, for example, is making it easier to build new coal plants by granting them free emissions permits, even though it aims to reduce emissions to 40% below the 1990 level by 2020. Enel hopes to persuade the governments of Bulgaria and Romania to do the same. In America, the most prominent proposals for regulations to reduce emissions all involve generous hand-outs to the coal industry. For a supposedly dying breed, advocates of coal-fired generation still seem to have plenty of clout with Europe's and America's politicians.

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BHP Billiton and Rio Tinto

Financial prospecting

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Mining companies have figured out how to boost reserves—takeovers

IN THE aftermath of the second oil shock at the end of the 1970s, as prices rose and new oil became harder to find, it was often said that the best place to drill for oil was in the canyons of Wall Street. Such thinking led to a wave of consolidation in the next 20 years. Now the mining and steel industries are following the same path as soaring demand and prices provide the bigger companies in both fields with the means and the incentive to buy their rivals. The latest, biggest example is the $360 billion merger proposal made by BHP Billiton, an Anglo-Australian firm that is the world's biggest mining company, to Rio Tinto, the industry's number three.

The steel-industry mergers of the past couple of years, notably the multinational Mittal group's takeover of Arcelor, a European steel giant, and the acquisition of Corus, an Anglo-Dutch firm, by Tata Steel of India, were both driven by booming demand from China and India. The steelmakers wanted to increase their scale and hence their bargaining power with the mining companies that sell them ore, which were raising prices as a result of demand from Chinese steelmakers. That demand has also driven up mining companies' share prices, enabling the big firms to buy smaller ones. This summer, Rio Tinto snapped up Alcan, a Canadian aluminium producer, for $38 billion.

But BHP Billiton's offer for Rio Tinto, announced on November 8th, takes consolidation to a new level. It would be one of the biggest mergers in history. The move had been rumoured for months, and came just six weeks after the appointment of BHP Billiton's new chief executive, Marius Kloppers. Rio Tinto's shares briefly leapt by 30% after it rejected the bid, as investors waited eagerly for a better offer.

On November 12th Mr Kloppers spelled out the details of his plan. Three BHP Billiton shares would be offered for each Rio Tinto share, putting a premium of 28% on the latter's recent value. He also revealed a scheme to sweeten the deal for Rio's shareholders, who would own 41% of the combined entity, through a $30 billion share buy-back on completion of the merger. This repurchase seems to be aimed largely at Rio's London-listed shares. If it is accepted, one effect would be to keep about half the merged company's shareholder base in Australia—potentially an important consideration for competition authorities there. For the moment, there is no talk of a hostile approach.

The business logic of the deal outlined by Mr Kloppers includes synergies worth as much as $3.7 billion a year within seven years. Not all of these benefits would flow from removing head-office duplication and overlapping operations such as mines and the railways linking them to ports. About $2 billion a year is expected to come from a higher throughput of minerals. Together, the argument goes, the two companies could better direct scarce resources to extract iron, copper, nickel and so on where the most value is to be gained, and do so faster than they could individually.

Mr Kloppers was careful to deny that one aim of the merger was to gain additional pricing power. But the Australians hate their status as mere quarrymasters to Asian industry and are in the middle of a round of negotiations with China's steelmakers. Iron-ore prices have tripled in the past five years. If the merged group controlled 40% of the world market for iron ore, might prices not rise even faster in future? The merged firm would also be dominant in aluminium, uranium and coking coal. Antitrust enforcers may well insist on disposals as a result. They may also point out that mergers are no substitute for finding new reserves—an activity the mining giants have neglected in recent years.

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Business in France

Au revoir, papa?

Nov 15th 2007 | PARIS
From The Economist print edition

More evidence that French capitalism is joining the modern world

THEY used to call it *le capitalisme à la papa*. The same old faces and the same old bankers would sit around the same old boardroom tables. They would make polite contacts and then take discreet cross-holdings in each other's companies to fend off hostile bids and shore up existing management. But last week's manoeuvrings around Saint-Gobain and Lafarge, two large building-materials firms, provide evidence of how much things have changed in French industry. The names on the dance cards may be the same, but everyone is bopping to a different tune.

Two illustrious names of the French-speaking financial world, Wendel of France and Groupe Bruxelles Lambert (GBL) of Belgium, were behind the latest fuss. Wendel is the post-industrial incarnation of a manufacturing group that, like Saint-Gobain, is more than 300 years old. Its chairman is Ernst-Antoine Seillière, a legendary figure in French capitalism over the past 30 years and the head of Business Europe, the continent's employers' organisation. GBL, meanwhile, is the main vehicle of another veteran dealmaker, Albert Frère—the shareholder France's president, Nicolas Sarkozy, had to win over before he could fashion the privatisation of Gaz de France by merging it into Suez, a utilities group, in September.

On November 7th Wendel said it had raised to 15.5% the stake of 6% that it had bought in Saint-Gobain, one of the world's leading building-materials companies, barely six weeks earlier. The extra purchase makes it the largest shareholder, just as GBL is the largest shareholder in Lafarge, the world's biggest cement company. For years market speculation has been aligning these two pillars of the French building industry for merger. But while the long-serving Jean-Louis Beffa was Saint-Gobain's managing director as well as chairman (a post he retains), his position as the “pope of French industry” meant that almost no one had the effrontery to mount a bid. The exception was François Mitterrand, whose government briefly renationalised the firm in the 1980s. (It was originally set up in 1665 by Louis XIV to make the mirrors for the Palace of Versailles.)

In the old days Wendel's action would have meant one of two things: either that it had been invited to raise its stake by Saint-Gobain as a defensive measure to keep a potential buyer at bay, or that it was acting in concert with GBL and planned to orchestrate a merger of the two building-materials firms. And indeed a story has appeared in *Le Figaro* saying Wendel has been pushing Saint-Gobain to propose a merger with Lafarge to create a global French construction champion.

It is not clear, though, that a merger would make sense. Saint-Gobain, keen to shed its conglomerate discount, has refocused on supplying expensive building products in developed markets (and it still makes the windows for half of all European cars). Lafarge, meanwhile, is concentrating on selling bulk building materials to China and other Asian markets.

Conversations have recently taken place between Pierre-André de Chalendar, Saint-Gobain's new managing director, and Bruno Lafont, the affable new boss of Lafarge, but Saint-Gobain denies any merger proposal. Lafarge has refused to comment. Wendel, for its part, says only that it is interested in talking to Saint-Gobain's management about identifying areas where opportunities for growth could be improved. Rather than old-style French meddling, in short, Wendel says its move is that of a modern activist shareholder, raising its stake to increase its influence over Saint-Gobain's strategy.

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Capsule hotels

Thinking small

Nov 15th 2007
From The Economist print edition

Hotels with tiny rooms, pioneered in Japan, are spreading and evolving

WITH their tiny, cupboard-like rooms and prices as low as ¥2,000 ($18) a night, capsule hotels have existed in Japan since the 1980s, but have not caught on elsewhere. They have, however, helped to inspire a new breed of inexpensive, no-frills hotels outside Japan that are not quite as small and not quite as cheap. In 2005 easyGroup, the parent company of easyJet, a low-cost airline, opened easyHotels in Hungary, Switzerland and Britain, with rooms from $22 a night. (As you would expect, extra amenities, such as windows or television, cost extra.) The latest examples of the genre, which opened this year, have added a further twist: they combine small rooms at low prices with cutting-edge design and technology.

Yotel, a British company, opened its first hotel inside London's Gatwick airport in July. Its tiny rooms, or “cabins” (pictured), draw inspiration from both Japanese capsule hotels and the first-class accommodation on a British Airways airliner. The “premium cabin” contains a full-sized foldaway bed, a toilet and shower, electrical points, a desk, free wireless-internet access and a flat-panel television. The “standard cabin” has a slightly smaller bed. Room rates start at £25 ($52) for four hours or £55 per night. The company will open another hotel at Heathrow airport on December 1st, and plans a third at Amsterdam's Schiphol airport in early 2008. This hotel will be behind the security cordon, which should appeal to travellers with connecting flights.

We can squeeze you in tonight

Amsterdam is also the site of the first mini-sized hotel in a chain called Qbic being launched by a Dutch start-up company. Its rooms, starting at €39 ($57), have adjustable mood lighting (“Mellow Yellow”, “Red Romance” or “Deep Purple Love”) along with a flat-panel TV, wireless-internet access and bathroom fittings designed by Philippe Starck. Like a low-cost airline, Qbic keeps prices down with online booking and self-service check-in.

Across the Atlantic, meanwhile, New York's Pod Hotel, which opened this year in midtown Manhattan, offers a double room with a bath from $109 and a single room from $89. Its success shows that customers do not mind small rooms (on average, American hotel rooms are three times the size) provided they are in a prime location.

All this illustrates that an “era of experimentation” is under way in the hotel industry, says Jennifer Fiorentino of Jupiter Research, a consultancy. Although there are no hard numbers on the quantity of capsule-like hotels around the world, she says, both Yotel and Qbic are moving forward plans for additional properties in 2008, which suggests that tiny rooms could have a big future.

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Coffee

Move over, espresso

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From The Economist print edition

A new machine could reshape the speciality-coffee business

NEAR the hard-working espresso machine at Ritual Coffee Roasters, a café in San Francisco, sits a stainless-steel box about the size of a desktop computer. This box, the Clover, produces a cup of coffee with a spectacle of streaming water, whirring motors and an ingenious inverse plunger. Zander Nosler, the industrial designer who invented the Clover nearly three years ago, seems to have done the impossible: attracted a cult following for a new coffee-making machine that is both slower and vastly more expensive than other machines and requires the undivided attention of a trained operator.

Where coffee-lovers are in Clover

Coffee has been stimulating innovation ever since it was first extracted with water hundreds of years ago, but developments in the café had reached their previous acme with the invention of the espresso machine in the early 20th century. That device, made to speed Italian commuters along with fresh, individual doses, now rules cafés worldwide. Most developments since have focused on convenience. Nestlé's Nespresso system, for example, uses disposable capsules. This obviates grinding and packing and makes cleaning effortless, but because the capsules are proprietary it also locks users in.

Even so, says Mr Nosler, “the hardware side of the business is woefully behind the times.” He cites medical devices, one of his other areas of expertise, as an industry with a far higher rate of technical progress. But unlike a blood pump, the Clover has social attributes as important as the coffee it makes. It was only after Mr Nosler modified a fully automated prototype to allow its operator to control almost every aspect of brewing that the Clover struck a chord with café owners and coffee drinkers.

In the past decade, changes in the way the finest coffee is produced and traded have given roasters unprecedented access to small lots of exceedingly good beans, spawning artisanal roasting and wine-like focus on *terroir*. These coffees are at their best in a lighter roast, and served as single-origin brews—neither of which works well in an espresso machine. Yet brewed coffee is the neglected stepsister in most cafés.

By allowing its operator such close control, the Clover permits super-speciality roasters to extend obsessive handling of their beans all the way into a cup and, if they are adept, to bring forth their best qualities. But a Clover is a big commitment. Bruce Milletto, a retail consultant to the coffee industry, notes that a typical American café spends around $50,000 on equipment, about one-quarter of which goes on an espresso machine. At $11,000, a Clover costs the same again.

Yet the expense can be worth it. Eileen Hassi, Ritual's owner, says the Clover enables her to sell individually brewed cups of coffee from a menu of rare beans, and to do so profitably. “There is no waste,” she says, “and the coffee is so good people have no problem paying $6 for a cup.” One recent morning,

workers from a nearby sewage plant stopped by for $3.50 cups of coffee from Muramba, in Rwanda.

This sort of enthusiasm explains why 100 Clovers were sold in 2006, the first year of production. Mr Nosler's privately held company now employs 11 people in Seattle and has tripled its sales this year. Mr Nosler hints that his sleek contraption may soon appear in much larger café chains. That could present a challenge: with its ability to develop all of a coffee's flavours in the cup, the Clover makes flaws painfully obvious. But the super-speciality part of the coffee industry often leads the rest, and the Clover's spread could help stimulate demand for better coffee, facilitating further change in the way beans are grown and roasted. And therein lies Mr Nosler's hope: for that is the very path espresso has taken.

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Food companies

Bitter times at Hershey

Nov 15th 2007
From The Economist print edition

As commodity prices rise, America's biggest chocolate-maker is in trouble

THE steep rise in food prices is separating the wheat from the chaff in the management of big food companies. So far this year Nestlé and other big European firms have managed to avoid raising prices too much, and have even increased sales and profits. But American companies have not coped so well. Announcing poor results for the third quarter of the year at the end of October, Irene Rosenfeld, Kraft's boss, said record commodity prices would continue to take a bite out of profits.

Unhappy with the lacklustre performance of American food companies, some investors are becoming restive. A fund run by Nelson Peltz, an activist investor who specialises in food firms, bought an estimated 3% of Kraft to push the maker of Philadelphia cheese and Ritz crackers to make more of its portfolio of famous but tired brands. Last week Kraft tried to appease Mr Peltz by letting him appoint two board members. And on November 12th Mr Peltz made an undisclosed bid for Wendy's, a struggling fast-food chain that has long been one of his targets.

With all its eggs in one basket, the Hershey Trust Company, which controls Hershey, America's biggest chocolate-maker, and has deep roots in the Pennsylvania town of the same name, is more restive than other food investors. After repeated clashes with Richard Lenny, Hershey's chief executive, the trust held meetings with Cadbury Schweppes, a British food giant, without inviting him. In October the trust said Mr Lenny would "retire" by the end of the year, and took the unusual step of issuing a statement that it was unhappy with Hershey's performance.

This week the trust went a stage further. On November 11th it sacked six directors of Hershey's board. Two more resigned, so only David West, the incoming chief executive, and Robert Cavanaugh, a member of the board of the Hershey Trust, remained. The trust appointed new board members including Arnold Langbo, a former boss of Kellogg, and Thomas Ridge, a former governor of Pennsylvania and a former secretary of the Department of Homeland Security.

Mr Lenny has not done well at Hershey. The company's share price has declined by 20% over the past 12 months, and net income in the third quarter of this year was 66% lower than in the same period last year. "Rick Lenny pushed growth too far too fast," says Robert Moskow, a food analyst at Credit Suisse, an investment bank, in New York. This was, to be fair, what the trust told him to do. But he cut advertising expenses too much and launched too many new lines such as Cacao Reserve, a classy type of chocolate. And he failed to cope with the soaring price of milk.

The trust's purge does away with some talented executives, and the new board is not a world-class team, says one insider. Mr Ridge has no experience in the food business and will mainly represent the interests of the state of Pennsylvania. "The trust is tightening its grip on the company, which minimises the chances of a sale," says Terry Bivens, a food analyst at Bear Stearns, an investment bank in New York. (The trust tried to sell the company to Wrigley in 2002, but backed out when state officials threatened to block the deal.)

Hershey remains much coveted. It has 43% of the American chocolate market, the world's biggest. The maker of Hershey Kisses and Reese's Peanut Butter Cups makes little impact abroad, so teaming up with Cadbury or another international firm would make sense. But the trust does not want to dilute its ownership of Hershey, and Hershey cannot buy Cadbury without taking on huge debts. With Hershey likely to remain on its own for the time being, Mars, its biggest rival, will continue to eat away at its market share—as it has done all this year.

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The Wall Street Journal

Brace yourselves

Nov 15th 2007
From The Economist print edition

Even before assuming control, Rupert Murdoch is making his mark

ON NOVEMBER 8th a group of past and present *Wall Street Journal* editors and Dow Jones executives gathered at the Morgan Library in Manhattan to mark the retirement of Paul Steiger, former managing editor of the *Journal*. The party had been planned before Rupert Murdoch made his bid for Dow Jones, but its timing, a few weeks before he is due to take control on December 13th, meant that "it felt like we were seeing the paper off to sea," says an editor who went. The new owner could not attend, though he was invited.

America's journalistic establishment will scrutinise every move Mr Murdoch makes with the *Journal*; many newsmen fear that he may damage it by taking it downmarket or using it to further his wider commercial interests. The new owner seems intent on shaking things up as quickly as possible. After months of hints, he confirmed this week that he intends to make its website free. That goes against the wishes of the *Journal's* publisher, Gordon Crovitz, who believes that wsj.com should remain partially a paid site, insiders say. In the next few weeks Mr Crovitz will make a presentation to Mr Murdoch outlining the financial impact of various options for the site—but his new boss seems to have made up his mind.

Reuters

Things are gonna change around here

Mr Murdoch reckons that the *Journal* could dominate the market for financial information online. A free wsj.com, he thinks, could attract 10m-15m regular readers from around the world (compared with 3.1m unique monthly users in September, according to comScore); the resulting increase in ad revenue would more than offset the loss of subscription income. Such a shift would be near-impossible to reverse. The *Financial Times* (owned by Pearson, part-owner of *The Economist*) recently took a step in the same direction, offering up to 30 free articles a month. But the FT will not go completely free, whatever happens at wsj.com. "We're confident in the value of our content and plan to keep subscriptions as a part of our online model," says John Ridding, the FT's chief executive.

In early January the *Journal*'s bureau chiefs and senior editors will meet Mr Murdoch to discuss his plans. His next priority, after wsj.com, will be the American edition: he would like it to compete more directly with the *New York Times*. To that end, he plans to expand the *Journal's* political coverage. Next, Mr Murdoch will focus on the *Journal's* European and Asian editions, which he has called "less than satisfactory". In recent years Dow Jones has cut costs repeatedly at both foreign editions. It is unclear whether he wants the two papers to continue producing stories mainly for American readers or to serve their local markets. The latter course would pose a much bigger threat to the FT and the *International Herald Tribune*, which is owned by the *New York Times*.

Of all the comments that Mr Murdoch has made about the *Journal* since his offer for Dow Jones was accepted, the most worrying for the paper's journalists was the criticism he made of its humorous front-page "A-hed" stories. After being shown research about how readers love the A-heds, say people at Dow Jones, "he backed off." But Mr Murdoch is likely to encounter similar opposition in other areas. Of course, much will be forgiven if he spends as heavily on the *Journal* as he has promised. "There's a ton of money at News Corporation already earmarked for the paper," says a person close to him. In the unhappy world of American newspapers, where cost-cutting has become a way of life, lavishing money on journalism would constitute a radical new strategy.

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Proton

Lost compass

Nov 15th 2007
From The Economist print edition

A stumbling manufacturer plans an "Islamic" car

MALAYSIA'S struggling national carmaker, Proton, claimed this week to have identified a huge gap in the world's car market. It believes there is demand for an "Islamic" car. The idea stems from desperation, but it is not as batty as it first seems.

Carmaking represents a big chunk of many economies. It brings jobs, advanced manufacturing techniques and national pride. But carmakers find it devilishly hard to make money, especially when volumes are small. Proton has struggled to make headway since it was created almost 25 years ago, despite protectionism and lots of state aid.

Its position has become especially dire recently. Its domestic market share has fallen from over 60% to 23% in the past five years after a cut in import tariffs, and the firm now appears to be heading for the industry's exit ramp. It has meagre export sales of around 20,000 cars a year, which go mostly to tiny markets such as Brunei, Nepal and Bangladesh. As a consequence, Proton is facing mounting losses. It lost M$591m ($169m) in the year to March on sales of barely 130,000 cars. Compared with its much larger international rivals, Proton is a vulnerable minnow.

Hence its latest wheeze (and there have been many): a plan to build an "Islamic" car in association with carmakers in Iran and Turkey. Iran, which dreamt up the idea, has a big car market with several manufacturers building vehicles under licence from foreign firms such as Peugeot and Renault. But, with a desire to skirt international sanctions and create more jobs, it has long wanted a car industry of its own. It just needs someone to provide the technology.

Turkey has not expressed a wish to create a home-grown car industry, but it is one of the largest Muslim car-buying markets. Together, the Iranian and Turkish markets might give Proton a chance to achieve economies of scale. And as demand grows in other more populous Muslim countries such as Indonesia and Pakistan, sales of an "Islamic" car, the thinking goes, would surge.

But is Proton really in a position to lead such a venture? Its most ambitious recent model, the Gen-2, was a flop. Such is Proton's desire to remain independent—partnership discussions with various international carmakers over the years have all foundered—that it is unlikely to be keen to share know-how. And if indeed Proton has identified a new market, its rivals will surely soon be on the scene. As planned, its "Islamic" car will feature a compass to indicate the direction of Mecca, a box in which to store a copy of the Koran and a compartment for a headscarf. This, Proton seems to think, is a formula that no other carmaker can match. That seems unlikely.

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Face value

Maximum Bob

Nov 15th 2007
From The Economist print edition

Bob Lutz was hired by General Motors to give its cars some much-needed sparkle. It seems to be working

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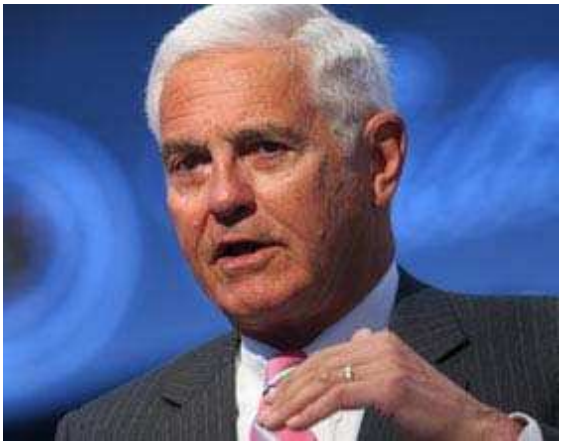

Get article background

FOR a man whose company has just recorded one of the largest quarterly losses in American corporate history, Bob Lutz, vice-chairman and chief of product development at General Motors (GM), seems remarkably chipper. Most of the $39 billion third-quarter loss stemmed from a $38.6 billion write-down of tax credits that does not affect GM's cash position. But the decision to make the write-down is a sign that despite record revenues and two years of restructuring in North America, cutting tens of thousands of jobs, GM is still struggling to make profits from its automotive operations.

By his own admission Mr Lutz is not the best person to talk about GM's accounting policies. But he is convinced that GM is now firmly back on track. The reason? For the first time since the 1960s, it is making great cars again. The cigar-chomping 75-year-old former Marine fighter pilot was hired by Rick Wagoner, GM's boss, to do just one thing: transform the appeal of the cars it sells. Six years on, Mr Lutz thinks his work is finally bearing fruit.

So do more neutral observers. Many of the new models launched over the past 18 months have won plaudits for their design and overall quality. The latest, the sporty Cadillac CTS and the mainstream Chevrolet Malibu sedan, are being compared favourably to rival products from European and Japanese carmakers—something almost inconceivable only a little while ago. A range of big sport-utility vehicles (SUVs) with the two-mode hybrid system GM has developed with Mercedes and BMW has also been warmly received. Mr Lutz says this shows that technology can make even traditional SUVs “less obscene”. After years of decline, GM's market share in North America is now edging up, to around 25%, even though the firm has slashed dealer incentives and reduced sales to car-rental firms.

Mr Lutz, who began his career 44 years ago at GM, has also worked for BMW and Ford. But his greatest claim to fame is his stint at Chrysler between 1986 and 1998, which ended when Daimler paid $36 billion to buy the company. It was the cars that Mr Lutz was mainly responsible for—the Dodge Viper sports car, the hotrod-style Plymouth Prowler, the Dodge Ram pick-up, the swooping “cab forward” Chrysler 300M and the retro PT Cruiser—that made Chrysler so desirable. The cars broke little new ground technically, but they looked great and stood out from the crowd. It was a brilliant conjuring trick that made Chrysler look much better than it really was. Looking back, Mr Lutz says: “The cars were OK for their time, but they wouldn't cut it now. Compared with GM the talent at Chrysler was a lot thinner and the competition in those days was a lot easier.”

Nonetheless, it was Mr Lutz's ability to produce cars that appeal to the emotions that convinced Mr Wagoner to bring him to GM. Mr Lutz says it was a recognition that the analytical approach to the auto industry does not work. “US car companies are run by brilliant, highly numerate people whose approach is to make the product in a highly rational way,” he says. “The way left-brain people run the car business is formulaic, based on what has worked historically—never forward-looking. Rick decided he wanted a right-brain guy.” Just about all cars made today, says Mr Lutz, “except maybe those made in China”, perform the basic functions efficiently and reliably, so there is now much more of a premium on design. Mr Lutz believes he has an innate understanding of what makes a car cool. “People say, ‘Show us your data’,” he says. “I don't have any. But if I see a car that turns me on, I know it will turn on other people.”

When Mr Lutz arrived at GM, he says, he concluded that the way the huge firm ran product development was “doomed” to fail. New-car programmes were run by vehicle-line executives who each had a designer allocated to them—so nobody had overall control of design. GM's design chief at the time, Wayne Cherry, told Mr Lutz that he hated the results. So Mr Lutz took on a role that he compares to those of both an artist-in-residence and a football coach. “My job is to drive the team to creative excellence,” he says. “At GM there are people with remarkable skills, which means you should be capable of doing anything. You replace the coach and the same team starts winning.”

Whatever turns you on

One project that emerged without any analysis or data is the Chevrolet Volt, a plug-in hybrid concept car that first appeared at the Detroit motor show earlier this year. Mr Lutz says he was thinking about how GM could outdo the hybrid Toyota Prius and that it came to him as an epiphany: “I know. We'll do an all-electric car.” The Volt's motive power, unlike the Prius's, is entirely electric, and can come either from batteries charged from the mains, which will give it a range of more than 40 miles, or from a small on-board internal-combustion engine that works as a generator. Mr Lutz admits that even he was shocked by the interest stirred up by the Volt. “Some people said it was a fake, a PR exercise,” he says. “We said: ‘We'll show 'em’.”

Mr Lutz is sublimely confident that the Volt will come to market in about three years' time. By early 2008 he expects to have development cars running, complete with the advanced lithium-ion batteries they will depend on. Mr Lutz reckons GM will at first build up to 100,000 Volts a year, priced at less than $35,000, but that production will be constrained by the need to create an all-new supply base. “Every component has to be redesigned for low-energy use,” he says. Mr Lutz adds that he is more excited by the Volt than any project he has ever worked on. He is “hell-bent” on re-establishing GM's technical leadership, and these days that means being the greenest carmaker. Apart from the Volt, what would he like to be remembered for? “I'd like them to say I was the person who re-focused the company on uncompromising product excellence, as opposed to the attitude that asked how much do we have to do to be competitive,” he says.

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Correction: Google

Nov 15th 2007
From The Economist print edition

Last week's story on Google's mobile-phone strategy ("What, no phone?", November 10th 2007) wrongly described Google as America's most valuable firm. At the close of trading on November 14th, Google was in fact merely America's seventh most valuable firm. Sorry.

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America's economy

Getting worried downtown

Nov 15th 2007 | WASHINGTON, DC
From The Economist print edition

Whether or not it's an official recession, America's economy will feel grim

Get article background

Robin Chavalier

IN RECENT years, it has rarely paid to be pessimistic about America's economy. Time and again, worried analysts (including *The Economist*) have given warning of trouble as debt-laden and spendthrift consumers are forced to rein in their spending.

So far, that trouble has been avoided. The housing market peaked early in 2006. Since then home-building has plunged, dragging overall growth down slightly. But the economy has remained far from recession. Consumers barely blinked: their spending has risen at an annual rate of 3% in real terms since the beginning of 2006, about the same pace as at the peak of the housing boom in 2004 and 2005.

At the same time, rapid growth in emerging markets coupled with a tumbling dollar has provided the American economy with a new bulwark, one that strengthened even as financial markets seized up over the summer. Exports soared at an annual rate of 16% in the third quarter. Thanks partly to strong export growth, revised GDP figures due on November 29th are likely to show that America's output grew at an annual rate of around 5% between July and September. Never mind recession: that is well above the economy's sustainable pace of growth.

But the good news may be about to come to an end. The housing downturn has entered a second, more dangerous, phase: one in which the construction rout deepens, price declines accelerate and the wealth effect of falling prices begins to change consumers' behaviour. The pain will be intensified by a sharp credit crunch, the scale of which is only just becoming clear. And, in the short term, it will be exacerbated by a spike in oil prices—up by 25% since August—that is extreme, even by the standards of recent years. The result is likely to be America's first consumer-led downturn in close to two decades.

Home is where the rot starts

The biggest source of gloom is housing. Despite almost two years of plunging construction, the collapse of the property bubble is far from finished—and its impact on broader consumer behaviour has barely begun. So far, the housing recession has been a builders' bust. Housing starts are down by 47% from

their peak and residential building now accounts for 4.4% of GDP, down from a record of 6.3% in 2005. That is a big drop, but not yet unusually long or deep by historical standards. Nouriel Roubini and Christian Menegatti, of Roubini Global Economics, point out that the seven other housing recessions since 1960 lasted an average of 32 months and saw housing starts fall by 51%.

Judging by the large number of unsold homes and the pace at which buyers are cancelling contracts (around 50% according to some homebuilders), it is clear that builders have further to cut back. Richard Berner, of Morgan Stanley, expects a further 25% decline, taking the pace of housing starts in 2008 to below 1m, the slowest since records began in 1959.

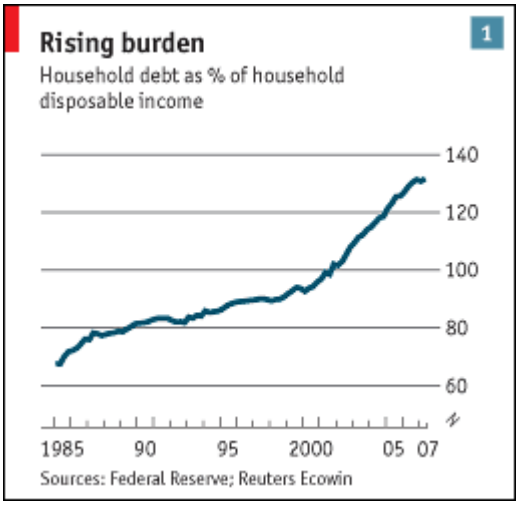
A builders' bust will not, by itself, drag the economy into recession. Most post-war construction busts have been followed by recession, but only because they were triggered by tighter monetary policy to head off inflation. The housing busts were a symptom of a forthcoming recession rather than the cause. This time, the source of trouble lies with the bursting of the housing bubble itself.

Since 1997, house prices have more than doubled in real terms. That increase has coloured America's economy in ways that go far beyond the construction boom. In particular, rising house prices provide consumers with the collateral they need for a huge increase in borrowing.

Up to their necks

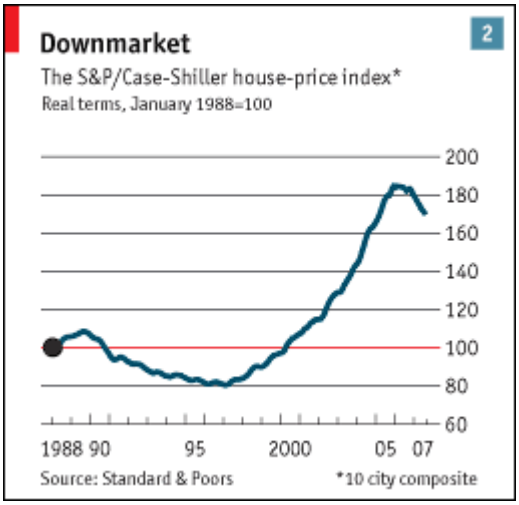
Relative to their incomes, consumers have been taking on more debt for decades, as America's increasingly sophisticated financial system allows more people more access to credit. But the pace of indebtedness has accelerated dramatically. The ratio of household debt to disposable income is now above 130%. Earlier this decade it was 100%; in the early 1990s it was 80% (see chart 1).

That credit expansion was made possible by rising house prices. Now they are falling, credit conditions are tightening. Both shifts are just beginning. According to the S&P/Case-Shiller index, arguably America's most accurate national measure, house prices have fallen by around 5% in nominal terms since their peak, or 8% once inflation is taken into account. That is a tiny drop compared with the past decade's rise (see chart 2).



Nor, judging by the pipeline of unsold homes, is it enough of a drop to bring demand in line with supply. Unlike shares, whose prices change quickly, house prices are often “sticky” as homeowners are loth to acknowledge their houses are now worth less. But the coming months are likely to see a sharp jump in the supply of homes for sale under distressed conditions. More than 2m subprime borrowers face markedly higher mortgage payments over the next 18 months as their interest rates are adjusted to new levels. Many will be forced into foreclosure.

This constellation will drive house prices down. Most Wall Street seers expect a drop of around 10% in nominal terms over the next year or so, but price declines of 15% or even 20% are no longer regarded as outlandish. Economists differ on how, and by how much, falling house prices will affect consumers' spending. But empirical studies suggest that changes in house prices have a bigger effect on consumer spending in countries, like America, where credit markets are deepest.



The most recent research implies that changes in Americans' housing wealth affects their spending more than similar changes in their financial wealth, although the effect takes longer to emerge. A $100 fall in financial wealth is traditionally associated with a $3-5 decline in spending. An equivalent fall in housing wealth, it seems, eventually reduces spending by between $4 and $9.

Given that America's stock of residential housing is worth some $21 trillion (or almost one-third of all

household assets), a 10% drop in house prices would make a discernible dent in consumption growth. If the spending response were at the top of economists' estimates, for instance, consumer spending would slow by almost two percentage points. The economists' studies, however, suggest that effect will be gradual: falling house prices will be an ongoing drag on consumer spending, rather than a sudden brake.

So far, this brake has been eased by strong gains in financial wealth. Thanks to higher stock prices, American households' overall assets have still been rising smartly. If the stockmarket loses momentum along with the economy, the wealth effect on consumer spending could appear quite quickly.

A wholesale credit crunch would make matters much worse. No one is yet sure how tight credit will get. It depends on how big the losses from the subprime-related mess turn out to be; who holds those losses; how far banks are forced to take troubled assets, such as those in structured investment vehicles, onto their balance sheets; by how much they cut back lending in response; and how far the Federal Reserve reduces short-term interest rates to compensate.

Three months after the summer's financial turmoil first hit, the omens do not look good. Entire markets for securitised assets are shrivelling: the asset-backed commercial-paper market has shrunk for 13 weeks in a row and is now 30% smaller than in August. Estimates of the eventual losses from the subprime-related debt mess continue to rise.

Ben Bernanke, the chairman of the Fed, recently put the losses from bad mortgage loans at $150 billion, up sharply from the $50 billion to $100 billion he expected early in the summer. And even that may be too low, given that some $1.3 trillion-worth of subprime loans alone were originated between 2004 and 2006. Deutsche Bank now estimates overall subprime-related losses at up to $400 billion, of which $130 billion will belong to banks. Write-downs of that scale will eat into even the best-stuffed capital cushions.

By some measures, banks are already hunkering down. According to the Fed's most recent survey of loan officers, a quarter of banks tightened their standards on consumer loans (other than credit cards) in October, up from only 10% in July. Four out of ten banks demanded higher standards on prime mortgages, up from 15% in July. The pace at which banks are tightening their mortgage-lending standards rivals that of the early 1990s, when the banking sector as a whole was much weaker and less well capitalised (see chart 3). But since tighter mortgage standards are themselves a response to the housing bust, they may overstate the extent of an economy-wide credit crunch.

Shocked by oil

Many Americans, however, will find credit harder to come by. And just as they do so, the third blow will come: that of higher fuel costs. Although it has fallen back this week, the benchmark price of crude oil is still above $90 per barrel, almost 25% higher than in August. This surge has not been fully reflected in American petrol prices, largely because refineries had unusually fat margins earlier in the year. Average petrol prices are up 33 cents per gallon (or 12%) since mid-August. Unless crude prices fall dramatically, much dearer petrol lies ahead. If oil stays near to $100 per barrel, some analysts are talking about $4 per gallon by next summer.

Higher fuel costs are the equivalent of a tax on consumers, reducing the amount of money they can spend on other things. Jan Hatzius, of Goldman Sachs, reckons that a rise in petrol prices of one cent reduces consumers' overall disposable income by about $1.2 billion, and tends to drag consumer spending down by $600m. Over the next few months, he reckons, higher fuel costs could reduce consumer spending by 1.2% at an annual rate. Overall, this drag will be smaller than the combination of tighter credit and falling house prices, but its impact will be concentrated over a shorter period.

A final cause for concern is the labour market. Low unemployment and solid wage growth have been a big reason for consumers' resilience thus far (see chart 4). With unemployment at 4.7% and 166,000 new jobs in October, that strength looks intact. But careful inspection suggests that October's numbers mask a wider slowing. The pace of net job creation has fallen

from a monthly average of 189,000 in 2006 to 118,000 in the past three months. Details from the household-based employment survey, which may be more accurate when the economy is slowing, are even darker. It shows very little net job growth in 2007, and an unemployment rate that is already up by three tenths of a point from its nadir.

Add this all up and it is small wonder that consumers are feeling gloomy. Most gauges of consumer confidence have been plunging of late. The University of Michigan's index is at its lowest level in 15 years, leaving aside the aftermath of Hurricane Katrina. The latest evidence suggests spending is already weakening: core retail sales were flat in October.

Consumer spending, at around 70% of GDP, is by far the biggest determinant of the economy's fate. But it is not the only one. The odds of a downturn also depend on whether other engines reinforce—or counteract—consumers' weakness.

One wild card will be firms' investment. Corporate spending is historically volatile, often helping to tip an economy into a formal downturn. In America's last recession, in 2001, plunging investment was the source of trouble, as firms worked off the investment excesses of the late 1990s. Today, corporate America is in much stronger shape. Overall, balance sheets are healthy and profits strong. But as Martin Barnes, of Bank Credit Analyst, points out, domestic non-financial firms, the ones that do most capital spending, have been doing rather less well, with profits down by 9%, compared with a year earlier, in the first half of 2007. Corporate investment may not drag the economy down, but nor is it likely to offer a boost.

That role belongs elsewhere—to foreign trade. America's exports have been booming while import growth has slowed sharply. That has narrowed America's trade deficit and boosted output. Exports will not continue to grow at the torrid rates seen in recent months, but with the dollar showing scant signs of a turnaround and with emerging economies, in particular, looking remarkably resilient (see article), exports will remain an important prop. At 12% of GDP, they are now easily able to offset the drag from weaker construction.

Recession or not?

Put all this together and do you get a recession? Many analysts expect a sharply slower economy, but not an outright recession—using the popular definition of two consecutive quarters of falling GDP. Wall Street's seers have shaved their projections for GDP growth in the fourth quarter of 2007 to around 1.5%. Most of them expect a couple more similarly weak quarters thereafter. A few long-standing bears, such as Mr Roubini, are convinced recession is inevitable. But most forecasters reckon the odds remain below 50%.

Yet history cautions against taking too much comfort from this. It is true that pessimists tend to predict recessions more often than they occur, but it is equally true that mainstream forecasters usually fail to predict those that happen. In both 1990 and 2001, Wall Street's seers were predicting modest growth when the economy, it turned out, was already contracting. History also shows that America's economy can swing quickly from strong growth to contraction. During the first three months of 1990 the economy was growing at 4.7%, but it was in recession by July. Adjust Wall Street's forecasts for their inherent conservatism and an outright recession seems all too plausible.

The bigger point is that even if the economy technically avoids a recession, it will feel like one to most Americans—because it will be led by consumers. That will be a big change. Consumer spending has not fallen in a single quarter since 1991; it has not fallen on an annual basis since 1980. Consumers barely noticed America's last recession—when low interest rates and high house prices kept them spending solidly (see chart 5). Just how voters and politicians react to a consumer downturn in an election year is worryingly uncertain.

What's more, the squeeze on consumers will last longer than many expect because it involves the unwinding of an asset-price bubble and attendant financial excesses. Just as corporate spending stayed weak for years after the 2001 recession, so consumer spending will be crimped for more than a few months. There seems little reason to expect, as many analysts seem to, that the housing bust will be history by the second half of 2008.

Finally, policymakers' responses may be more muted. In 2001, the economy was cushioned by a large fiscal boost, thanks to tax cuts and bigger spending, as well as much lower interest rates. A big tax cut now seems extremely unlikely. At the same time, the weak dollar and global economic strength that softened the downturn will also complicate the central bankers' ability to respond. Based on underlying inflation expectations, real interest rates are still above 2%. Central bankers often push short-term real rates to zero, or even below, in a downturn, suggesting there is plenty of room to cut, particularly since the housing glut means lower interest rates may pack less punch. But high oil prices and a falling dollar may preclude such an aggressive response, as Mr Bernanke worries about rising inflation expectations. Recession or not, America faces a tricky road ahead.

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Emerging economies

Dizzy in Boomtown

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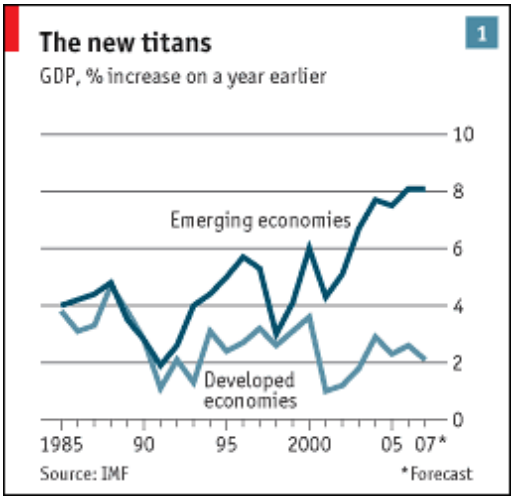
From The Economist print edition

Robin Chavalier

The boom in emerging economies and their stockmarkets is not over yet. But some are likely to run out of breath sooner than others

THE world is experiencing one of the biggest revolutions in history, as economic power shifts from the developed world to China and other emerging giants. Thanks to market reforms, emerging economies are growing much faster than developed ones. There is a widening gap between their growth rate and that of the sluggish developed world (see chart 1). According to the IMF, this year they are growing almost four times as fast.

Emerging economies account for 30% of world GDP at market exchange rates (and over half using purchasing-power parity to take account of price differences). At market exchange rates they already account for half of global GDP growth. And by a wide range of measures, their weight is looming larger. Their exports are 45% of the world total; they consume over half of the world's energy and have accounted for four-fifths of the growth in oil demand in the past five years (explaining why oil prices are so high); and they are sitting on 75% of global foreign-exchange reserves.



The increasing strength of emerging economies has been reflected in their stockmarkets, which have climbed steeply in recent years. Share prices in many emerging economies are showing signs of altitude sickness, with recent sharp falls in China and other markets. Even so, since 2003 Morgan Stanley Capital International's emerging-market index has jumped more than fourfold in dollar terms, compared with an increase of only 70% in America's S&P 500. Top of the mountain has been Brazil, with an incredible gain of 900% (see chart 2). Over the same period, emerging economies' output has grown by 35%; the developed world's by only 10%. More than ever before, emerging economies are being relied upon to help lift the world economy. But can they keep up the effort?

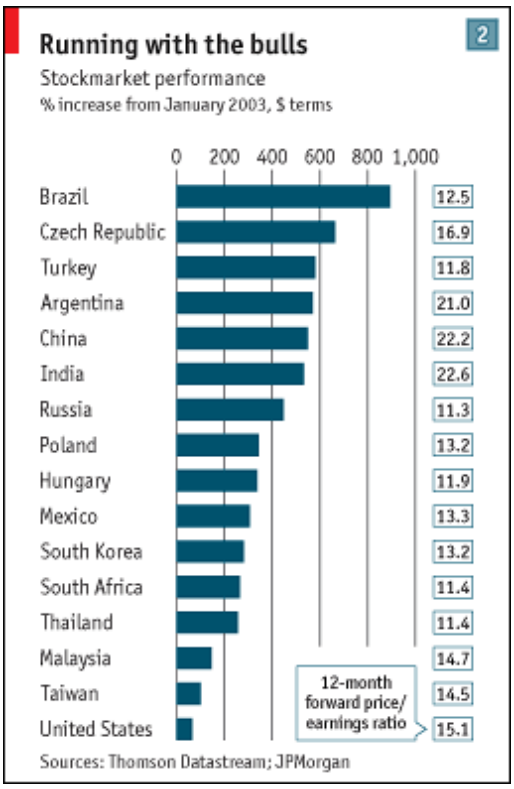
Sounder footings

They may be able to. On many measures emerging economies

look sounder than some developed ones. As a group they are no longer financially dependent on foreigners: together they run a current-account surplus, and thanks to large reserves and reduced debts, are now net foreign creditors. They have smaller budget deficits, on average, than rich countries, and inflation rates remain historically low. Unlike so often in the past, most currencies do not appear to be notably overvalued and hence prone to collapse; if anything, many are undervalued.

What is most striking is that this year, for the fourth year running, all of the 32 emerging economies tracked by *The Economist* show positive growth. This is a remarkable turnabout: in every previous year since the 1970s at least one suffered a recession, if not a severe financial crisis.

But it is dangerous to treat emerging economies as homogenous. This brings back alarming memories of the early 1990s, when investors poured money into any fund with an "emerging market" tag. On April 1st 1994, when buying fever was at its peak, a Hong Kong stockbroker advised clients to buy shares in Bhutan Dry Docks. He immediately received several large orders even though Bhutan is a landlocked Himalayan kingdom which then did not even have a stockmarket.



Investors need to discriminate carefully between countries.
Although emerging economies have never before looked so healthy, aggregate numbers conceal some horrors. Table 3 shows *The Economist*'s ranking of 15 of the biggest economies according to potential economic risk. It is based on the size of current-account balances, budget deficits, credit growth and inflation. A country's overall score is arrived at from the sum of the rankings of each indicator. It is obviously only a crude gauge, but it reflects the economic factors that have caused trouble in the past. A similar ranking would have flashed red for Thailand in early 1997 just before the Asian financial crisis.

The riskiest economies, all with current-account deficits and relatively high consumer-price inflation, are India, Turkey and Hungary. Those with current-account deficits are vulnerable to a sudden outflow of capital if global investors become more risk averse. Economies where inflation and credit growth are already high and budget deficits large, such as India, have less room to ease monetary or fiscal policy if the economy weakens.

3 Sorting the sheep from the goats

Country	Current-account as % of GDP*	Budget balance† as % of GDP*	Bank lending % increase‡	Inflation %‡	*The Economist*'s risk ranking
Thailand	3.7	-1.9	2.0	2.5	1=
Malaysia	14.4	-3.2	10	1.8	1=
South Korea	0.1	2.3	14	3.0	3=
Taiwan	6.8	-2.0	3.5	5.3	3=
China	11.7	-1.0	18	6.5	5
Poland	-3.7	-3.2	9.7	2.3	6
Mexico	-0.7	*nil*	24	3.8	7
Russia	5.9	8.4	55	9.5	8
Argentina	0.9	1.4	36	8.4	9
South Africa	-6.7	1.3	24	7.2	10=
Czech Republic	-3.4	-3.7	24	2.8	10=
Brazil	0.8	-3.3	37	4.1	12
Hungary	-5.6	-6.7	14	6.4	13
Turkey	-7.5	-2.3	23	7.0	14
India	-2.1	-6.3	24	6.4	15

Sources: National statistics; *The Economist*'s estimates *2007 forecast †General government ‡Latest =: Tied rank

Being irrational

The nature of capital inflows also matters. Foreign direct investment is much safer than speculative capital. But according to Chetan Ahya, an economist at Morgan Stanley, 85% of India's capital inflows this year have been in the form of debt or portfolio investment, much of which has gone into the stockmarket. India shows dangerous signs of irrational exuberance. It was swept by euphoria last month as the Sensex, India's benchmarket index, hit 20,000 for the first time. India's *Economic Times* declared, “The first 10,000 took over 20 years. The next came in just 20 months...Superpower 2020?” Instead, India's poor risk-rating should ring alarm bells.

China's economy looks less risky thanks to a small official budget deficit (many reckon that it really has a surplus) and its vast current-account surplus and reserves. The other two members of the so-called BRIC group, Brazil and Russia, also have a better risk-rating than India. Russia's credit boom is frightening, with lending up by 55% in the past year, but the economy is sheltered by large external and budget surpluses, thanks to high oil prices. After running a current-account deficit for most of the previous three decades, Brazil has had a surplus for five years—also thanks to robust commodity prices.

Emerging Europe, however, is flashing red, with widening current-account deficits, rising inflation, soaring bank lending and property bubbles. Indeed, Hungary and Turkey appear prudent compared with the Baltic states. Latvia has a current-account deficit of 24% of GDP, inflation of 13% and property prices rising at an annual 60%. The economy is seriously overheating, but its currency is pegged to the euro, which means it cannot raise interest rates. Estonia, Lithuania, Bulgaria and Romania also have current-account deficits of more than 12% of GDP. If these smaller economies were included in the table they would all rank at the bottom, below India.

A large chunk of bank lending in the Baltics and other parts of emerging Europe has been denominated in, or indexed to, foreign currency. The combination of large external financing needs and private-sector currency mismatches looks suspiciously like Thailand in 1997. These economies are highly vulnerable to a change in investor sentiment: if a rapid outflow of capital caused currencies to collapse, debts would soar in local-currency terms.

At the other extreme, Thailand, Malaysia, Taiwan and South Korea have not only the lowest risk ratings, but also share prices that look less overvalued than elsewhere. In Thailand, Malaysia and Taiwan price/earnings (p/e) ratios are still below their 20-year average.

Emerging stockmarkets now have a higher average p/e ratio than developed markets for the first time since the early 1990s. Stocks used to trade at a discount because these markets were seen as riskier. Now their economies are less wobbly and profits grow faster than in the rich world. This might justify a higher valuation. But the size of some p/e ratios causes concern that a bubble is in the making.

There was a stumble in emerging markets this summer when America's subprime crisis began to unfold. But after the Federal Reserve cut its discount rate in August investors eagerly returned, pushing prices up by an average of 40% in dollar terms by the end of October. Markets that looked cheap in August started to look dear, so it is hardly surprising that some investors have recently needed a breather.

In any case, the average p/e ratio in emerging markets may be distorted upwards because of a different industrial mix. Some types of businesses have consistently higher ratios, and emerging-countries tend to have more of them. When comparing like with like, the average p/e is still lower in emerging economies than in the developed world, according to UBS.

International comparisons can also be blurred by different accounting conventions. It is better to compare a country's p/e ratio with its own track record. Emerging markets' average p/e of 14.7 (based on forecast 2008 profits) is now above its 20-year average of 14, but it is nevertheless still well below previous peaks (see chart 4).

China A shares have been the frothiest this year, up by 104%. Thanks to frenzied buying at its stockmarket debut, PetroChina is now by some measures the world's most valuable company—three of the world's five largest companies are Chinese. A forward p/e ratio for A shares of 40 (again, based on forecast profits) certainly looks bubbly, but it too is much lower than in previous bubbles. The p/e reached 80 in Japan in the late 1980s, while on America's NASDAQ it hit 90 in 2000.

The p/e for Chinese shares that foreigners can buy is a more modest 22, well below the 40 reached in 2000. In contrast, Indian shares, also with a p/e of 22, have never been so overvalued. And while p/e ratios of 11-12 in Russia and Brazil seem like a screaming buy, relative to their historical averages of 7-8 they look generous.

Rolling along

Emerging stockmarkets experienced a similar boom in the early 1990s, until ended by a series of painful crises: Mexico at the end of 1994, East Asia in 1997, Russia in 1998, Brazil in 1999, Turkey in 2000, Argentina in 2001 and Venezuela in 2002. By 2002 the Morgan Stanley emerging-market index had lost almost 60% of its 1994 dollar value. So why should the current boom be any more sustainable?

A common feature of bubbles, such as America's dotcom mania and more recently its housing boom, is that most people refuse to believe they are bubbles until they burst. In sharp contrast, plenty of people have denounced China's stockmarket as a bubble, most notably Alan Greenspan, the former chairman of the Fed. The recent dive in prices makes such warnings seem prescient.

Yet a report by Goldman Sachs argues that many of the common symptoms seen when bubbles are about to burst are missing in today's emerging markets. Not only are p/e ratios much lower than in previous bubbles, but economic and financial imbalances created by rising asset prices, such as widening external deficits, are also absent from many economies. Likewise, before bubbles burst, notably America in the late 1990s and Asia in 1997, profits started to shrink. They are still growing strongly in China and the rest of Asia.

There is also ample global liquidity to fuel further gains. Just as previous interest-rate cuts by the Fed helped to pump up both the dotcom bubble and America's housing bubble, further easing over the next year could inflate emerging markets even more. These economies' domestic monetary conditions are also loose. Over the past year their broad money supply has increased by an average of almost 20%, accounting for a staggering three-fifths of the total expansion in the world's money. The surplus of money growth over and above the growth in nominal GDP (a crude measure of the money available to be invested in financial assets) has been growing at its fastest pace for years.

Several analysts therefore predict that after taking a short breather, emerging-market mania will resume. Bubbles will get bigger before they burst. Chris Wood, a strategist at CLSA, predicts that emerging Asia's forward p/e ratio will peak at twice America's. The premium now is only 5%.

Foreign money seems likely to continue to pour into emerging-country stockmarkets, if only because they lag so far behind the rest of the world. While emerging countries account for 30% of world GDP, they account for only 11% of world stock-market capitalisation.

Over the coming years, faster growth in profits and hence share prices, along with new share issues by companies, will almost certainly boost the value of these markets. According to a recent report by Ernst & Young, China, India, Russia and Brazil accounted for nearly half of all money raised worldwide in initial public offerings in the third quarter of this year.

One risk is that such prospects will attract too much interest from abroad. The surge in emerging-market shares has been a boon for international investors, but large inflows of foreign capital may be less welcome to governments and central banks. According to the IMF, net inflows of private capital to emerging economies have surged to almost 4% of their GDP on average this year, surpassing the peak of the previous wave in the first half of the 1990s. Net inflows to Brazil and Argentina have been running at 5-6% of GDP; and emerging Europe even more.

Vast capital inflows can harm economies in several ways. Not only can they inflate asset bubbles and spur excessive borrowing, but they can also cause a steep rise in the exchange rate, damaging the competitiveness of export sectors. If a country already has a current-account deficit this will make it even more vulnerable to a quick reversal of capital. On the other hand, if central banks intervene to hold down their currencies, the build-up of reserves can lead to excessively loose monetary conditions and rising

inflation. This is exactly what is happening in much of emerging Europe.

Many other emerging economies have allowed their exchange rates to rise against the dollar. The Brazilian real has jumped by 23% this year, and by a total of 100% since 2003. In response to rising inflation, the Reserve Bank of India has allowed the rupee to rise by 12% since April. It has been greeted with howls of protest from business, yet the rupee has risen by no more than the Chinese yuan since mid-2005 and by much less than many other Asian currencies, such as the Thai baht.

Could a sudden crash in emerging stockmarkets derail the boom? Most stockmarkets are much smaller in relation to GDP than in developed economies, so the wealth effects of a crash would be modest. The East Asian economic slump in the 1990s was not caused by stockmarkets crashing, but by over-borrowing and the severe currency mismatches which caused the local currency value of debt to explode when currencies fell. This is a serious risk in the Baltics, but elsewhere most economies do not display the same sort of financial imbalances.

A more imminent threat is the impact of an American recession. Economists argue fiercely about whether emerging economies can decouple from the United States, yet by some measures they seem to have done so already. Emerging economies' exports to America slowed markedly this year, but their GDP growth has been supported by robust domestic demand and strong exports elsewhere.

If exports to America weaken further, many governments can support demand by boosting public spending, thanks to more prudent budgeting than in the past. Anyway, America is less important as an importer than it used to be. The share of China's exports going to America (including re-exports through Hong Kong) has fallen from 34% in 1999 to 24% now. China exports more to other emerging economies, which as a group now send more to China than to America. This partly explains why as American imports have slowed this year, the emerging world has continued to boom. So long as China's economy remains robust, it will help to pull other emerging economies along.

Indeed, this year for the first time emerging economies are likely to have bought slightly over half of America's exports, helping to prop up the economy of the United States. Some years into the future, economists may instead ask: “Can America decouple from China?”

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African banks

On the frontier of finance

Nov 15th 2007 | ABUJA, JOHANNESBURG AND NAIROBI
From The Economist print edition

Illustration by Satoshi Kambayashi

Taking advantage of more stable economies, banks are venturing deep into sub-Saharan Africa

NOT so long ago, a cruel joke among international bankers was that sub-Saharan Africa was less an emerging market than a submerging one. Local bankers had no reason to change that impression; for all the political and economic turmoil, tiny and informal markets, and shabby infrastructure, they mostly made good money doing very little. Using low-cost deposits to buy high-yielding government bonds, they harvested some of the best net-income margins in the world. The corollary, of course, was that most Africans had no access to financial services.

Nowadays, the thinking is shifting. According to the IMF, Africa is enjoying its best period of sustained economic expansion since independence. Real GDP growth is expected to rise from 5.7% in 2006 to 6.1% this year and 6.8% in 2008. This good performance is partly driven by high commodity and oil prices. Foreign aid has also helped. But it is also due to better economic management, more openness and more stable politics. Such policies mean banks have to work harder to make a profit, but also help them to grow. That is encouraging them to reach out to new customers—and so they should. A report from the World Bank on November 13th argues that promoting access to financial services in Africa should be a priority, as it boosts growth and helps reduce the income gap between rich and poor.

Still, only 20% of families in Africa have bank accounts. Small and medium-sized firms struggle to borrow; private credit accounts for 18% of GDP in Africa—and less than 5% in Angola, Chad, Congo, Guinea Bissau and Sierra Leone—compared with 30% in South Asia. Ethiopia, Uganda and Tanzania have less than one bank branch per 100,000 people. Opening an account in Cameroon requires $700—more than many of its people earn in a year. In Swaziland, a woman needs the consent of her father, husband or brother to open an account or take a loan, and 75% of adults do not have a verifiable address. Even in South Africa, where the financial sector is far more sophisticated, almost half of adults do not have bank accounts.

Millions of Africans stash money under their mattresses or keep their savings as cattle. In countries such as South Africa, Kenya and Uganda, many turn to informal services, such as burial societies or savings clubs. Microfinance outfits have filled some of the gap. But they are small, and banks are usually much better equipped to provide financial services on a large scale.

In many countries, not only are better and more predictable monetary policies improving the environment for banking; privatisation of state-owned banks has also created opportunities, and better regulation has helped too. In 2004, Nigeria's central bank raised the minimum capital requirement for banks from 2 billion nairas ($15m) to 25 billion, and it limited government ownership in banks to 10%. The number of

banks has shrunk from 89 in 2004 to 25 today, but the number of branches has increased by over 600. So far, experts say, placements on the red-hot stock exchange have provided most of the increased capital. Some banks' returns on equity are believed to be shrinking. But ATMs have become so much a part of life in Nigeria's big cities that lines sometimes stretch down the street. There are also welcome signs of prudence: one Nigerian bank, United Bank of Africa, promises no "*wahala*" loans. All Nigerians know *wahala* means "trouble".

The improving climate has caught the attention of foreigners. The Industrial and Commercial Bank of China, in the largest ever single investment in Africa, has offered $5.6 billion for a 20% stake in Standard Bank, of South Africa, which has operations in 18 African countries. In 2005 Barclays, a British bank that has been working in Africa for over a century, bought a majority interest in ABSA, another South African bank. Its ambitions stretch across the continent, and it believes its sponsorship of the English Premier League, something of a religion in football-mad African countries, has given it recognition (so, less happily, has its colonial pedigree). "Africa is going from unbanked to banked," says Frits Seegers, a Barclays executive. Hitherto, the bank has served what it calls the top of the pyramid in Africa; now, spurred by competition from local African banks and by its experience in emerging Asian markets, it is targeting the middle and lower end.

South Africa serves as the Petri dish for the trans-African experiment (although its economy is so much larger than its neighbours' that results may not be perfectly replicable elsewhere). In the post-apartheid era, the government has nudged banks into creating simpler and cheaper products. They have taken branches to the unbanked, either in prefabricated form, or in vans that make regular visits to under-served areas. Other countries are doing the same. In remote areas where delivering cash is hard, mini-machines have been installed in corner shops where customers print out a slip confirming they are in the black and present it to the shopkeeper, who provides the cash. Some rural branches and ATMs rely on solar energy and satellite phone connections.

New technology also helps. Few Africans have a bank account, but many have mobile phones: in Kenya and Botswana, for example, 17% of those who are unbanked own a mobile phone, according to the FinMark Trust, a research group seeking to make financial services more accessible. In South Africa, Congo and Kenya, financial services are offered over mobile phones—though it is not always clear whether they can be called banks or not. Subscribers can open accounts, check their balances, pay their bills or transfer money by typing a few commands on their mobile phones. In Kenya, where 3m people have bank accounts, as many as 1m use M-PESA, a mobile-payment scheme.

Splashing out

South African banks, having learned lessons in their home market, are pioneering innovations elsewhere in the region. Standard Bank supplies an isolated branch on an island in Uganda's Lake Victoria by having planes drop bags of cash from the air. The bank credits its mobile sales force and its rapid roll-out of ATMs in Uganda—an extra 128 since it bought a local bank in 2002—to its success there. In a country of 30m people, it has opened close to 700,000 new accounts in five years, and controls 40% of the market. When its shares were listed on the minuscule local stock exchange this year, they were over-subscribed by 200%, and more shares were traded in one day than in the exchange's entire history. ABSA, meanwhile, is developing modern credit-scoring techniques for customers who have never been granted loans before. By keeping costs down and building up scale, it reckons micro lending is at least as profitable as its other services.

But competition among banks is growing. In Ghana, Barclays works with *susu* collectors, who gather money from small-scale market traders and keep it safe for them for a fee. The collectors' clients are typically too small for high-street banks, but Barclays reckons that they collectively represent a market worth £75m ($154m). The bank offers savings accounts, loans and training to the *susu* collectors, and says they have helped it reach 200,000 market traders. In two years, there have been no defaults.

For all the progress, much remains to be done. In spite of innovations to bring in new customers, banks still have to build up necessary scale, cut costs and manage risks better. Sub-Saharan African economies are growing, but except for a handful, they remain very small: South Africa's GDP alone makes up almost 40% of the whole. Relative poverty is declining, but four out of ten Africans still have to survive on less than a dollar a day. According to the World Bank, in 40 out of 48 countries in the region, it still takes over a year—and a long list of procedures—to enforce a contract. In Congo, Malawi, Mozambique and Sierra Leone, procedures to recover a debt cost more than the value of the debt itself.

Africa also remains far more vulnerable than other regions to the vagaries of weather, unpredictable aid

flows, and volatile commodity prices. With the exception of places like South Africa, most economies are not diversified and therefore are highly vulnerable to shocks. Countries such as Zimbabwe and Sudan also show that political stability cannot be taken for granted. This residual uncertainty and the lack of confidence in local banks help explain why those who can often prefer to keep their money abroad and why most private finance in Africa is short-term.

Many African countries still have to develop and enforce policies and laws allowing banks to compete and operate more easily, while making sure they are financially solid—and customers are protected. In time, regional integration may help ease the problem of scale. Meanwhile, millions of people are still waiting to take their cash from under the mattress.

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The Federal Reserve

Letting light in

Nov 15th 2007
From The Economist print edition

The Fed's new strategy amounts to low-cal inflation targeting

Get article background

HE GAVE no steer on future interest-rate decisions and no assessment of where he sees the economy going. Yet Ben Bernanke's speech at the Cato Institute in Washington, DC, on November 14th may be judged as the one in which he stamped his mark on America's monetary policy.

The Federal Reserve's chief used his speech to unveil the central bank's new strategy for communicating with the public. In short, the Fed plans to talk more—and more often—about its assessment of the economic outlook. While the Fed is not about to join the band of central banks that are guided by an explicit goal for prices, it will borrow some of the inflation-targeters' clothes. More than one Fed-watcher dubbed the new public-relations policy “inflation targeting-lite”.

Until now, the Fed has published two forecasts a year. Starting on November 20th it will publish projections once a quarter. The end-point for forecasts will be pushed out from two to three years hence. And alongside the forecasts will be a “narrative” that gives more detail on the differences on the Federal Open Market Committee (FOMC), the Fed's rate-setting body.

Lengthening the forecasts from two to three years is more important than it sounds. Three-year forecasts should be untainted by transitory factors that blow the economy off course. As a result, they will say a lot about how quickly policymakers think the economy can grow and how low they believe the jobless rate can safely go. And since forecasts are conditional on an “appropriate” setting for monetary policy, the longer-term projections will reveal the inflation rate the FOMC is aiming for. If views diverge, then Fed-watchers will have not one but several inflation “targets” to focus on.

Ever the diplomat, Mr Bernanke said that the new communications set-up is a “work in progress” and stressed it would not affect policy decisions. Yet his speech gives a clear sense of the kind of central bank he wants to run. The emphasis on providing a deeper insight into the spread of views on the FOMC signals a different approach from that of his predecessor, Alan Greenspan. Mr Bernanke said allowing diverse views reduces the risk that one voice becomes “unduly dominant”.

Another theme is a more prominent role for explicit benchmarks. Mr Bernanke acknowledged that his preference for an inflation target is not compatible with the Fed's “dual mandate”, which puts the goal of maximum employment on an equal footing with price stability. But he has nevertheless managed to find a way to get the Fed to be much clearer about its objectives. He acknowledged that one benefit of extending the Fed's forecasts for an extra year is that it will provide “an evaluation of certain long-run features of the economy.” And by agreeing to publish forecasts for headline inflation, as well as the less volatile core data, Mr Bernanke has also addressed the growing perception that the Fed thinks fast-rising food and energy costs are not its problem.

This is an opportune time to make the Fed's policymaking more open. As Mr Bernanke made clear, greater transparency will bolster the Fed's legitimacy and help preserve its independence. Since recent readings on inflation and activity are sending conflicting signals, the Fed will need an understanding and informed public if it is to make the right choices.

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Buttonwood

A yen for certainty

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From The Economist print edition

Why markets are likely to remain hyperactive

MAY you live in volatile times. That variation of the old Chinese curse must resonate with investors and traders trying to make sense of turbulent markets. On November 13th the Dow Jones Industrial Average, which had suffered two 360-point daily drops over the previous month, enjoyed a 320-point rally.

That reversal was accompanied by four other abrupt changes in recent trends. Financial stocks rebounded after both Goldman Sachs and JPMorgan Chase reassured investors about their exposure to the subprime-mortgage mess. The yen retreated from its 18-month high against the dollar. Commodities fell back, with gold retreating below $800 an ounce and oil apparently abandoning its assault on the $100-a-barrel level. And Treasury bonds gave up some of their gains, pushing yields higher.

This sudden shift could be seen as a rekindling of risk appetites. The biggest concern in recent weeks has been the sickly state of banks' balance sheets, which has curbed the appetite for dollar assets (driving up the yen) and encouraged investors to seek the havens of Treasury bonds and gold. The good news from Goldman encouraged traders to cut those bets.

But anyone who really wants to know how investors feel needs to look at the yen, and here there is bound to be more seesawing. According to Ken Fisher of Fisher Investments, the correlation between the euro-yen exchange rate and the fortunes of the global stockmarkets has been almost perfect this year. When the euro rises against the yen, the markets gain; when they fall, they fall together.

The best explanation for the link is probably the “carry trade”, although it might be better described as the “risk trade”. Speculators who want to use borrowed money to finance their positions are naturally inclined to use yen because the cost of funding is virtually zero. When stockmarkets are going up, the yen thus tends to fall as it is sold to buy positions in other markets. But if markets fall, the speculators attempt to cut their risks, requiring them to buy back yen.

This use of borrowed money means these shifts in markets can be sudden, as we have seen in recent weeks. Indeed, such a tendency can be self-fulfilling, since investors know their rivals will also want to change their positions quickly.

But what is driving sentiment in the first place? Clearly, there has been a feeling that the worst news about the credit crunch has yet to emerge. As one investor puts it: “It's rather like fishing with dynamite. The tiddlers come to the surface quite quickly. It takes a while for the big fish to float to the surface.”

What has been remarkable, as David Bowers of Absolute Strategy Research points out, has been the divergence between the fortunes of financial and non-financial stocks. “This is not like technology in 2000 which was an isolated sector,” he says. “This is the credit-creation arm of the economy.” This divergence cannot last. Either the rest of the economy must be dragged down by the banks, or (as may have started to happen this week) investors will decide that financial shares have been oversold.

The economic outlook has also caused concern. Recent data about the American, European and Japanese economies have all been distinctly mixed, and a decent performance in the third quarter of the year may well be followed by a slowdown in the fourth. In September investors were inclined to regard bad economic news as good news, reasoning it would prompt central banks to cut interest rates. But the continued strength of oil and food prices has kept headline inflation rates high, making it more difficult for monetary policymakers to be accommodative. Having acted to save the financial system when it is in crisis, they may be doubly determined to demonstrate their anti-inflation credentials in future.

Even the optimistic idea that strength in emerging markets (particularly in Asia) can keep the global economy going is a mixed blessing in inflationary terms. If Indian and Chinese demand have been pushing up food and oil prices in recent years, then that trend will continue, regardless of the health of American

and European economies.

It seems highly unlikely that this week's rally marks the end of the period of uncertainty. So much remains unknown, from the effect on American consumers of falling house prices, the ability of the corporate sector to maintain profits at current (historically high) levels, to the potential for the credit crunch to spread to other sectors such as commercial property. There will be probably a few more 300-point daily moves in the Dow before the year is over.

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Investment banking

Facing the Lynch mob

Nov 15th 2007 | NEW YORK
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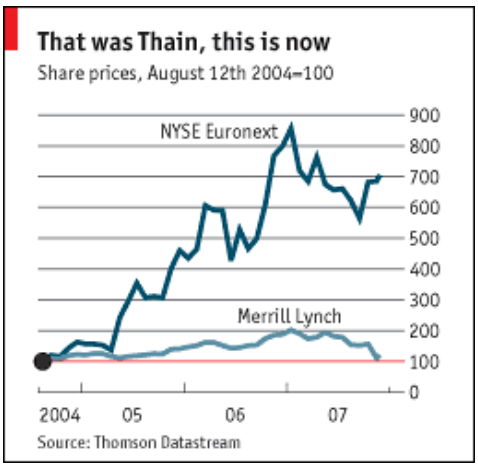
John Thain has a tough job ahead as the new boss of Merrill Lynch



THE Thundering Herd has a new leader but not the one most people were expecting. On November 14th Merrill Lynch picked John Thain, boss of NYSE Euronext, the world's largest exchange operator, to replace Stan O'Neal, who walked out after the bank booked enormous writedowns on its mortgage-linked holdings.

Most had been expecting the job to go to Larry Fink, head of BlackRock, a big and successful fund-management firm of which Merrill owns 49%. Mr Fink seemed to want the job and was considered a clean pair of hands, having deftly navigated his firm around the subprime crisis. According to reports, he was approached by Merrill's search committee but was then spurned by the full board after he demanded a lot more information about the bank's credit exposures. As more of a builder than a slasher, he may also have been reluctant to take on a role that is sure to involve painful job cuts.

Mr Thain is unlikely to be so queasy. Once dubbed “I, Robot”, his soft, almost dull, exterior belies a ruthless streak. He has done a good job of shaking up the New York Stock Exchange, taking it public, expanding into bonds and derivatives, and striking big deals, such as the industry-changing merger with Paris-based Euronext and an alliance with the Tokyo Stock Exchange. He also deftly managed the demise of floor trading, grafting the NYSE onto an electronic exchange, Archipelago.

Adding to his credentials, he has already turned around a troubled institution (the exchange was reeling when he took over in 2004, after Richard Grasso was ousted because of his enormous pay packet) and he has bags of experience in the areas where Merrill is most deficient (he ran the mortgage-bond desk at Goldman Sachs before becoming the investment bank's chief operating officer). His appointment will confirm to some that Goldman, which has so far avoided big write-downs, is gradually taking over Wall Street, especially since his successor at the NYSE is its president, Duncan Niederauer, another former Goldman man.

Mr Thain might see a merger between Merrill and his old firm or another large bank as his crowning achievement before entering public service (he is believed to harbour political ambitions). Meanwhile, he has plenty of dirty work to do. Merrill's fixed-income group must be pared back, with perhaps a quarter of it going. Further write-downs may be necessary. Risk management—a discipline in which Mr Thain is said to excel—needs to be spruced up, to put it kindly. He will also have to deal with subprime-linked lawsuits and a regulatory investigation of Merrill's accounting for illiquid assets.

Above all, he must decide if the business model, with precious investment bankers and bolshie brokers under one roof, needs to be reconfigured. If Mr Thain has a weakness, it is inexperience in retail financial services—and Merrill's brokers are feeling prickly at the moment, having watched the other half of the firm dent the brand. He is at pains to play down the prospect of wrenching change. “I don't think it's an issue of deconstructing. The strategy clearly is good,” he told CNBC, a business TV channel.

Eyes will now turn to Citigroup, which is also looking for a boss after the “retirement” of Chuck Prince. Mr Thain was coy about whether he was offered that job too. Whoever ends up running Citi faces a gigantic challenge, but at least he (or she) will have plenty of latitude: Robert Rubin, the new chairman (and yet another ex-Goldmanite), has indicated that no option is off the table, even a break-up. Mr Thain may not hog the limelight for long.

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Chinese banks

I scratch your back

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By inviting in a Chinese bank, America hopes for reciprocity

WESTERN politicians have been banging on Asia's door demanding greater access for their banks for so long that their fists must hurt. Increasingly, however, Asians are answering back, with some justification, “What about letting our banks operate in the West?”

On November 9th, a quarter of a century after the Bank of China became the first Chinese bank to win permission to open a branch in New York, and 18 years after Bank of Communications became the second, China Merchants Bank, the country's sixth-largest bank, became the third. It was a proud moment. Its president, Ma Weihua, said that the branch licence was an acknowledgment that Chinese banks now met global regulatory standards. In fact, the approval was as much an act of faith and of political calculation as a full endorsement. With this action, American officials hope that, in turn, restrictions on foreign firms doing business in China will be relaxed, especially those that hold sway over securities trading.

America's reluctance to grant licences to foreign banks stemmed from the implosion of Bank of Credit and Commerce International in 1991. It increased with concerns over money laundering and terrorist finance. Chinese banks were a particular cause of worry because of the risk of losses from politically directed loans.

But now that China Merchants is in, several more hope to follow. The two biggest, Industrial and Commercial Bank of China (ICBC) and China Construction Bank, have applications pending at the Federal Reserve. For all Chinese banks, earnings outside mainland China, Hong Kong and Macau are trivial. But in the past year there have been a flurry of investments, including big stakes by ICBC in Bank Halim Indonesia, Seng Heng Bank of Macau, and South Africa's Standard Bank. ICBC will not be the only Chinese bank to think that an American regulatory endorsement could be a step towards bigger things.

Bigger things have, all of a sudden, begun appearing on the horizon since a banking crisis erupted in the West. Over the past two years Western banks have made fortunes on minority investments in Chinese banks. Thanks to a stockmarket boom in China, its banks are now in a position to do the reverse. Theoretically, the biggest Chinese banks could buy Citigroup or HSBC. More realistically, they might purchase say 10% of a Western bank with weak assets.

Such a move would have a sound business logic, says a banker: Chinese banks are awash with liquidity; Western banks, thanks to the credit crunch, are short of it. Building a pipeline for the money to follow is not easy, however. Cultural barriers are huge, and non-Chinese regulators are opening a window to Chinese banks, not a door.

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Economics focus

Shock treatment

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Why the economy has absorbed high oil prices fairly easily, and why it may no longer

OIL prices have a special place in economic folklore. The two nastiest global recessions of recent decades were preceded by huge and sudden rises in the price of oil, first in 1973 and then in 1979. These twin spikes, both engineered by the Organisation of the Petroleum Exporting Countries limiting its oil shipments, are still the textbook example of an economic "shock"—a sudden change in business conditions. Abrupt increases in the oil price have prompted anxiety about stunted growth ever since.

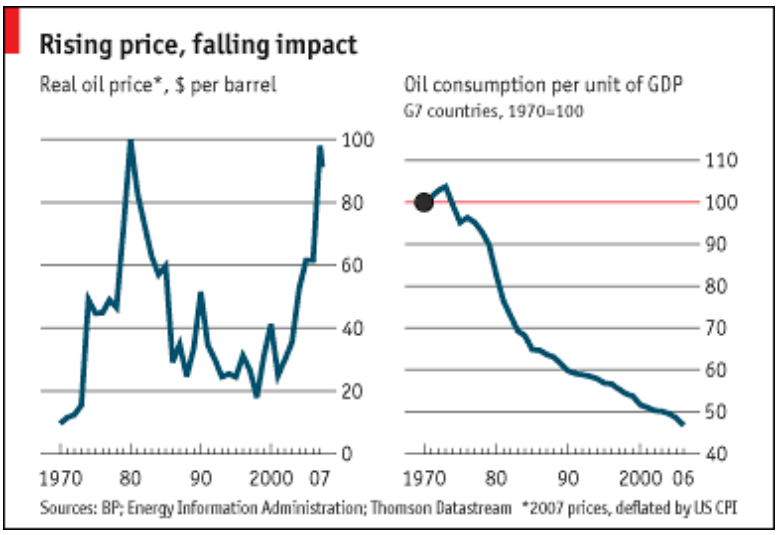
Higher oil prices hurt the economy because they act like a tax increase. Firms that use oil face higher costs which, if they cannot be passed on in higher prices, might mean that some production becomes unprofitable. Consumers paying more for their petrol and heating oil have less to spend on other things. If they look for higher wages to compensate for a drop in purchasing power, that will only lead to job losses.

Oil-producing countries benefit from higher crude prices so the impact on global demand depends how their extra income is spent. But even if oil windfalls are spent largely on goods produced by oil importers, the abrupt shift in the distribution of global income will still be destabilising.

Given the gloomy history, the lingering unease about higher oil prices is understandable. A demonstration of this came on November 13th when, after a rough few days, stockmarkets rose on news that the oil price had fallen below $93. After all the talk of breaking the three-figure barrier, a drop towards a mere $90 spurred a relief rally.

Yet for all that, something has changed. Today's oil prices would have been unthinkable until very recently. Six years ago, when a barrel of crude could be bought for as little as $20, oil prices at today's levels would have raised fears of deep recession. Notwithstanding the spectre of past oil shocks, crude prices have risen to ever-dizzier heights without derailing a five-year period of strong global growth. But why has the oil bogeyman become less scary? Two new papers* by three well-known economists set out to explain. They come to similar conclusions: oil shocks do not hurt as much because oil is used less intensively than before, because the economy is more flexible and because central banks are better at controlling inflation.

What makes oil special is that it is a uniquely dense and portable form of energy. It is not easy to switch to alternatives very quickly, so disruptions to supply are damaging. Yet improvements in energy efficiency mean dependence on oil is not what it once was. Rich countries use less than half as much oil as they did in 1970 for each inflation-adjusted dollar of GDP. So although prices in real terms have returned to levels last seen in the 1970s, their impact is not as powerful when set against the diminished economic importance of oil (see charts).



The blow from dearer oil is less powerful than it was and compared with their rigid state in the 1970s, today's more flexible economies are better able to take a punch. Higher oil prices have some unavoidable direct consequences on companies' production costs and on prices paid by consumers for oil-derived products. Wider damage to jobs and output depends on how well these increased costs are absorbed. If workers insist on higher cash wages to maintain their spending power, firms' costs will take an additional hit, resulting in lay-offs, higher unemployment and depressed demand. To the extent that workers take it on the chin, accepting higher oil prices as a temporary tax increase that lowers their real take-home pay, the collateral damage will be smaller. The rigidity of the 1970s economies, where union power and indexed contracts meant wages were unyielding, only magnified the adverse effects of oil shocks. Today's flexible jobs markets allow oil shocks to be absorbed less harmfully.

If consumers are more forgiving of oil shocks, it is partly because they have become more accustomed to volatile prices and partly because they have greater trust in policymakers to keep inflation under control. Dearer oil has pushed up consumer prices, but expectations of future price increases have remained remarkably stable. That in turn reflects a belief that central banks will act where necessary to keep a lid on inflation. There is a self-fulfilling aspect to that faith. Employees are less pushy in seeking inflationary wage deals and firms think twice about raising their own prices. As a result, central banks do not need to respond as aggressively as in the past to the inflation caused by higher oil prices. A less jerky monetary policy makes for greater stability.

Pump-action problems

Both papers help tell us why oil shocks hurt much less than they used to. But that is not to say that oil prices no longer matter at all. Neither analysis takes the run-up in oil prices over the last year into account. The rise in crude prices since the summer has been rapid even by the standards of the 1970s shocks and comes at a particularly bad time for America, the world's largest oil user. Consumers are now having to absorb a flurry of punches. Falling house prices, tighter credit conditions, rising unemployment, as well as higher prices at the petrol pump, all cloud the outlook for consumer spending.

Moreover, part of the cost of absorbing past oil-price hikes has been higher consumer debt and a huge trade deficit, both of which make America's economy more vulnerable. And though the Federal Reserve's credibility has allowed it to cut interest rates in anticipation of a downturn, the persistence of oil-led inflation may yet shift expectations of future price pressures, forcing the central bank to keep monetary policy on a tighter chain. America's economy no longer has the glass chin that it had in the 1970s. But a combination of powerful blows could still have a shattering impact.

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*"The Macroeconomic Effects of Oil Price Shocks: Why are the 2000s So Different From the 1970s?", by Olivier Blanchard and Jordi Galí. Massachusetts Institute of Technology Working Paper 07-21 (August 2007).

"Who's Afraid of a Big Bad Oil Shock", by William Nordhaus. Preliminary draft (September 2007) prepared for Brookings Panel on Economic Activity.

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Nuclear weapons

Reliable evidence?

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AP

America wants to ensure that its nuclear warheads would go bang rather than pop—but without letting them off to test them

OLD soldiers never die, they just fade away. Old weapons, on the other hand, hang around stubbornly. Those of the nuclear variety left over from the cold war are causing a bit of a nuisance. Thousands of them are ageing in silos. Ensuring that they do not deteriorate and would detonate if necessary is difficult. That is because of the Comprehensive Test Ban Treaty which, as its name suggests, forbids contracted parties from letting off nuclear explosives in peacetime.

Although America has yet to ratify this treaty, its policy is to act as though it had. It stopped the tests of real warheads (such as the one illustrated above) in 1992. That means scientists wishing to find out whether a particular batch is still potent cannot just pluck a warhead at random from the stockpile and try to explode it. One way to overcome this would be to replace the warheads with newer designs that, proponents argue, would not need to be live-tested in this way. The older warheads, the most elderly of which will reach the end of their 30-year design lifespan in 2008, could then be retired without compromising the country's nuclear shield.

The Reliable Replacement Warhead programme, as this scheme is known, has reached a crucial point. A full (and costed) design for the new warheads was supposed to be unveiled in December. However the National Nuclear Security Administration, the part of the Department of Energy responsible for the programme, said this week that the report is now expected by August 2008. Some people suspect it will be delayed yet further by the presidential election next year.

A year's delay will not matter much. But should the programme be cancelled (and funding for it, first authorised in 2005, was all but eliminated by Congress for this financial year), America risks finding itself without enough nuclear-weapons scientists to keep its arsenal in tip-top condition in the future. For the truth is that the Reliable Replacement Warhead programme is also a job-creation scheme, designed to persuade some of the country's best brains that it is worth trading a career in industry for one in national defence.

Testing without testing

Scientifically speaking, the programme's goals look possible. Earlier this year the National Nuclear Security Administration chose a design that it thinks could be developed without any further live tests. In September Jason, an elite group of independent scientists, published its evaluation of what technical

information it could assess about this design. It concluded that, in principle, it would indeed be possible to develop a replacement warhead without conducting any new nuclear tests. It recommended, however, that the final design be scrutinised in an independent peer-reviewed process. That would be a first. Allowing outsiders to assess a design for its strengths and weaknesses is not something that the Department of Defence has done in the past—and it is not, at the moment, proposing to change its mind.

According to Bruce Goodwin, who is responsible for nuclear technologies at the Lawrence Livermore National Laboratory in California—which, with the Sandia National Laboratories in New Mexico, put forward the winning design—the proposed replacement warhead is based on a weapon that was tested but not deployed some 20 years ago. The richness of the existing test data is what gave this design its winning edge over an alternative proposed by the Los Alamos National Laboratory (also in New Mexico, and which also had Sandia as a partner). Those data help to give confidence that “virtual” tests, run inside a supercomputer, will produce results that correspond to what would happen if a warhead were tested for real.

The quantities of data involved in such simulated tests are phenomenal. Staff at Lawrence Livermore say it takes their best computers six weeks to simulate what happens inside a warhead when it is going off. Such detailed modelling has only recently become possible. The supercomputers used in the early 1990s, when nuclear testing stopped, would have taken 60,000 years to process the same data.

Part of the reason for this is that a nuclear explosion has three stages. First, a specially shaped charge of chemical explosives surrounding a plutonium pit goes off. That compresses the plutonium while it is simultaneously bombarded with neutrons from a trigger made of polonium, and thus begins the second stage. In response to the neutrons, some of the plutonium atoms split apart, releasing energy and more neutrons. These, in turn, split more plutonium.

This is the famous chain reaction that lies at the heart of nuclear warfare. It is not, however, the source of a modern bomb's main explosive power, for just as the chemical explosives trigger a fission explosion by compressing the plutonium, that fission explosion is used to ignite the third stage, a still-larger fusion explosion, by compressing and heating the main part of the bomb. This is composed of a mixture of deuterium (a rare isotope of hydrogen) and lithium (a light metal). These react to form helium, yet more neutrons and a whole lot more energy. The result, a thermonuclear explosion, is what destroys the target, but the entire three-stage process has to be mimicked if computers are to test weapon-designs reliably.

The models involved in the winning Livermore/Sandia bid are certainly good enough to recreate the results of earlier tests (a trick known as “hindcasting”). Whether they can accurately forecast things, no one knows for sure. But so-called subcritical tests are allowed by the test-ban treaty, and that may add confidence to the process.

Some of these tests involve smashing or shooting at small shards of plutonium. Blowing up little bits of the metal this way, without compressing them in a symmetrical manner, is allowed because it does not result in a chain reaction. And the chemical-explosive detonator can also be tested using “simulants” that are not fissile but mimic the behaviour of the plutonium pit in other ways. Scientists can thus find out whether the charge would have detonated, had it been made of plutonium.

The fusion stage can also be examined within the rules. An enormous—and enormously expensive—system of lasers called the National Ignition Facility is being built at Livermore. It is designed to cause thermonuclear fusion in tiny pellets of deuterium (so small that they would not be covered by the test-ban treaty) and is expected to be completed in 2009.

For weapons scientists this is all exciting stuff. Not quite as exciting, perhaps, as letting bombs off for real, but not a bad substitute. The question for the politicians is whether that excitement—and the personnel and new bombs that will result from it—are worth the money. And that, in turn, depends on just what sort of nuclear arsenal America thinks it really wants.

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Human reproduction

Stress city

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The sex of a child may depend on how stressed its mother is

A BOY or a girl? That is usually the first question asked when a woman gives birth. Remarkably, the answer varies with where the mother lives. In rich countries the chances of its being a boy are about 5% higher than in poor ones. Equally remarkably, that figure has been falling recently. Several theories have been put forward to explain these observations. Some argue that smoking plays a role, others that diet may be important. Neither of these ideas has been supported by evidence from large studies. But new research points to a different factor: stress.

Strange as it might seem, the terrorist attacks of September 11th 2001 shed light on the enigma. Studies noting the sex of babies conceived in New York during the week of the attacks found a drop in the ratio of males to females. That is consistent with earlier studies, which revealed a similar shift in women who became pregnant during floods and earthquakes and in time of war. Moreover, a study carried out eight years ago by researchers at the University of Aarhus, in Denmark, revealed that women who suffered the death of a child or spouse from some catastrophic illness (such as a heart attack) around the time they conceived were much more likely to give birth to girls than to boys.

Taken together, these results suggest that acute stress to a woman at the time of conception shifts the sex ratio towards girls. However, Carsten Obel, a researcher at Aarhus who was not involved in the earlier study, wondered if the same might be true of chronic stress too. In a paper just published in *Human Development*, he shows that it is.

Dr Obel used a set of data collected between 1989 and 1992. During that period 8,719 expectant mothers were asked to fill in questionnaires that inquired, among other things, about their level of stress. Dr Obel found that the more stressed a mother had been, the less chance she had of having given birth to a boy. Only 47% of children born to women in the top quartile of stress were males. That compared with 52% for women in the bottom quartile.

Dr Obel suspects the immediate cause is that male pregnancies are more likely to miscarry in response to stress than female pregnancies are, especially during the first three months. However, that is difficult to prove. More intriguing, though, is the ultimate cause, for he thinks it might be adaptive, rather than pathological.

That is because the chances are that a daughter who reaches adulthood will find a mate and thus produce grandchildren. A son is a different matter. Healthy, strapping sons are likely to produce lots of grandchildren, by several women—or would have done in the hunter-gatherer societies in which most human evolution took place. Weak ones would be marginalised and maybe even killed in the cut and thrust of male competition. If a mother's stress adversely affects the development of her fetus (as it is likely to do) then selectively aborting boys, rather than wasting time and resources on bringing them to term, would make evolutionary sense.

That, in turn, would explain why women in rich countries, who are less likely to suffer from hunger and disease, are more likely to give birth to sons. That this likelihood is, nevertheless, falling suggests that rich women's lives may be more stressful than they used to be.

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Optical materials

Catching rainbows

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From The Economist print edition

How to halt light and bottle it

A FUNDAMENTAL law of physics says that nothing can go faster than light, which zips along at around 300m metres a second. But light can also travel at a more leisurely pace, slowed, for example, by air or water. This week a group of researchers led by Ortwin Hess of the University of Surrey, in England, announced a plan to stop light completely and store it, using materials that possess some odd properties. If the plan works, halting and hoarding light in this way could eventually lead to better computers.

The odd property on which Dr Hess's plan rests is called negative refraction. When a ray of light encounters a boundary, such as that between air and water, its speed changes; so does its angle of travel. This is why an object at the bottom of a pool seems to be closer to the surface than it truly is. The ratio between the speed of light in a vacuum and that in a material is known as the material's refractive index. Natural materials all have a positive refractive index. But what if a material could be built that had a negative refractive index, so that light was bent in the opposite direction and an object appeared to be farther from the surface than it really was?

Several years ago Sir John Pendry, a physicist at Imperial College, London, who was musing on this idea, realised that such a material would make a perfect lens. It could also be woven into an invisibility cloak. Other scientists have taken steps towards realising these ideas using materials that contain tiny metal structures which alter the electromagnetic properties of the material and thus its interaction with light. (Light is a form of electromagnetic radiation.) Now Dr Hess and his colleagues believe that a material with a negative refractive index could also stop light in its tracks and hold it there. They report their ideas in the current issue of *Nature*.

Dr Hess envisages a ray of light travelling down an optical fibre made from two materials: a core with a negative refractive index and an outer sheath with a positive one. The light would bounce along the core, reflecting from the boundary between core and cladding. Owing to an optical effect called the Goos-Hänchen shift after the duo who discovered it, the ray would be knocked slightly off course on each reflection.

In normal optical fibres made from materials with positive refractive indices, this makes the effective thickness of the cable greater than its physical thickness. That is a boon for sending information. But for reflections from boundaries between two materials, the inner one of which has a negative refractive index and the outer one a positive refractive index, the Goos-Hänchen effect instead narrows the width in which the light ray can bounce about. If the optical fibre is tapered, the light ray will become trapped at the point where the fibre is no longer wide enough to let it pass any farther. The light will be halted and held there.

This technique could, in principle, be used to store light of many colours separately. Because the precise thickness at which the fibre traps the light depends on the wavelength of that light, the proposed technique would halt the colours of the rainbow at different points.

The idea is just that at present—an idea. But materials that have negative refractive indices have already been made (at least for light with wavelengths that are too long to be visible), so the idea could be tested fairly easily. Moreover, Dr Hess and his colleagues think it would be straightforward to attach their invention to more conventional optical devices, because at points where the core of the optical fibre is thick, it would behave quite normally. And because it does not rely on any quantum-mechanical jiggery-pokery to perform its magic, their idea should work at everyday temperatures.

Catching a rainbow could be useful as well as merely cool. Engineers have long sought to do away with slow and messy electronics when building computers and instead to rely on light, which is far faster and does not get hot. That beams of light cannot be held stationary, and thus used as a form of memory store, is a big obstacle to doing this. Slowing the fastest thing in the universe to a standstill, therefore,

could speed things up elsewhere.

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Geophysics

Going to extremes

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Mapping the Earth with neutrinos

TELESCOPES that point down instead of up sound like a weird idea but, if they are designed to detect subatomic particles called neutrinos, they can tell astronomers what is happening in the sky on the other side of the planet. That is because most of the neutrinos that reach the Earth pass right through it. The planet thus forms a useful screen against other sorts of particles that might confuse the telescope. Such devices could, however, also see what is happening deep inside the Earth. At least, that is the suggestion made this week by a team led by Maria Gonzalez-Garcia of Stony Brook University, in New York state.

At the moment, the only data on the Earth's interior are the paths of earthquake waves that are reflected and refracted by the various layers of the planet's interior. These, together with reasonable guesses about the Earth's overall composition, have been used to put together the familiar model of an iron core, a rocky mantle and a thin crust. But the evidence is indirect. If Dr Gonzalez-Garcia is correct, then physicists will have opened a direct window on the subterranean world—at a minimal extra cost.

Most of the neutrinos that travel through the Earth come either from the sun or from sources far beyond the solar system. Some, however, are the result of collisions between cosmic rays and the gases of the upper atmosphere. As luck would have it, these tend to have about the right level of energy to be absorbed by rock more often than their extraterrestrial counterparts. That means they can, according to Dr Gonzalez-Garcia, be used like X-rays passing through a human body, to pick out denser rocks from lighter ones.

Of course, you would need an appropriate neutrino telescope to do this. Luckily, one is being built at the South Pole at the moment. Called IceCube, it will work by detecting the flashes of light generated on those rare occasions when a neutrino hits one of the atoms in a molecule of water in the ice.

When IceCube is completed in 2011, it will be a boon to astronomy. But it will also be the first telescope capable of spotting enough neutrinos to make it worthwhile to take measurements of the interior of the Earth. If Dr Gonzalez-Garcia is right, it will thus be the world's first geoscope as well.

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Picasso's life

His middle years

Nov 15th 2007
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Popperfoto

This third volume highlights Pablo Picasso's work for the stage and the influence of two women: his wife Olga (seen with him below) and his mistress Marie-Thérèse

THE first volume of John Richardson's magisterial and wonderfully readable life of Pablo Picasso came out over 15 years ago, and more than ten have elapsed since the publication of the second. In the meantime Mr Richardson has written two slimmer volumes. In 1999 he published his witty reminiscences of the decade or so he shared with the brilliant but impossible collector and art historian, Douglas Cooper, in Provence (during this time Mr Richardson became friendly with Picasso and hatched the idea of a biography). A couple of years later appeared his even more outrageous series of pen portraits of friends and acquaintances from the artistic and literary worlds entitled “Sacred Monsters, Sacred Masters”.

With these entertainments behind him, Mr Richardson has reverted to the more serious business of biography, though always with a keen eye for pretension and a delight in human eccentricity and folly. In fact, he occasionally seems more interested in the minor characters in Picasso's story—patrons, dealers, society hostesses and assorted hangers-on—than in his principal subject, especially if he can sniff out and expose some scandalous or shocking detail.

A Life of Picasso: The Triumphant Years, 1917-1932
By John Richardson

Knopf; 608 pages; $40.
Jonathan Cape; £30

Buy it at
Amazon.com
Amazon.co.uk

In an amusing chapter entitled “L'Époque des Duchesses”, he recounts with relish the fancy-dress balls given by Count Étienne de Beaumont, who “encouraged exhibitionism and transvestism” and “always managed to upstage his guests by appearing in one spectacularly androgynous costume after another, designed by himself.” Although professing to be bored by these evenings, Picasso went on attending them until 1925, if only to satisfy the social aspirations of his wife, Olga. An added reason may have been that the count was an important patron of the ballet, commissioning “Mercure” from Picasso, Erik Satie, the composer, and Léonide Massine, the choreographer, in 1924.

For Mr Richardson, a former ballet critic, “Mercure” was the most provocative of all Picasso's works for the stage and “a major milestone of avant-garde theatre”. Its striking costumes “paved the way for the open-work sculptures Picasso would embark on four years later”. By contrast, the author dismisses “Parade”, which had brought Picasso, Satie and Massine together for the first time seven years earlier, as “a gimmicky, quasi-modernist ballet”, largely as a result of Jean Cocteau's egregious contributions (the author seldom has a kind word to say for poor Cocteau).

The first half of this volume concentrates on Picasso's work for the stage. It opens with the artist's first visit to Rome in 1917 to work on the sets and costumes for “Parade”. Rome was where Sergei Diaghilev, the ballet's producer, and his company had their wartime base. Mr Richardson writes with verve on the effect the city had on Picasso: its brothels, music-halls and puppet theatres as much as its high culture. Naples, where Picasso spent a week, made an even bigger impact. He delighted in the outdoor *commedia dell'arte* performances and visited the National Museum where he saw erotic objects from Pompeii in its notorious Gabinetto Segreto.

But what captivated him above all were the famous monumental sculptures from classical antiquity in the Farnese collection in Naples. Picasso's search for monumentality in his own art, whether painting or sculpture, is one of the themes of this book. Mr Richardson returns again and again to the concept of “gigantism”—the disproportionate enlargement of limbs and other body parts for greater expressive and psychological effect—which gave Picasso's own classicism an ironic edge.

Rome was also where Picasso met and pursued Olga Khokhlova, one of Diaghilev's Russian dancers, whom he would marry in 1918. Their respectable, middle-class marriage and its gradual disintegration, against a background of Olga's declining health and increasing anxiety at her husband's infidelity, dominate Mr Richardson's story. The relationship inspired some of Picasso's most disturbing portraits, such as “Large Nude in a Red Armchair” (1929) and “Seated Bather” (1930), in which his wife's by now scrawny body undergoes either distortion or radical dismemberment and reconstruction. If there is one criticism to be made of Mr Richardson's analysis of these paintings, it is that he plays down the influence of surrealism on Picasso.

No trace of anger or misogyny can be found in Picasso's portraits of his curvaceous, nubile lover, Marie-Thérèse Walter, who entered his life aged 17 in 1927 and “saved him from the psychic stress of his marriage and the bourgeois restraints it imposed.” In a remarkable burst of creative energy in 1931 he transformed Marie-Thérèse's features into a series of monumental plaster heads (later cast in bronze) which simultaneously evoke male and female genitalia. They are among the most powerfully original sculptures of the 20th century. By contrast, his depiction, in one sketchbook, of his lover's “pumped-up body in the guise of his own engorged penis” was no more than an example of narcissistic fantasy.

One of the main reasons for the long gap between volumes two and three is the daunting costs of research and, not least, copyright and reproduction fees: as Mr Richardson himself once remarked, “I couldn't afford to do it.” Happily, the great and the good, not to mention the extremely rich, have come to the author's rescue, setting up the John Richardson Fund for Picasso Research. This has permitted the publisher to illustrate 60 of Picasso's works in colour, a big advance on the first two volumes which were illustrated entirely in black and white. Let us hope that the fund enables the indefatigable Mr Richardson, now in his 84th year, to polish off the remaining 40 years of Picasso's life in much less time than it took him to cover the 15 extraordinary years from 1917 to 1932—no easy task.

A Life of Picasso: The Triumphant Years, 1917-1932.
By John Richardson.
Knopf; 608 pages; $40.
Jonathan Cape; £30

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Turkey's Kurdish rebels

Goading Ankara to overreach

Nov 15th 2007
From The Economist print edition

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AFP

Come and get me

Blood and Belief: The PKK and the Kurdish Fight for Independence
By Aliza Marcus

New York University Press; 368 pages; $35 and £22.50

Buy it at
Amazon.com
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SINCE the late 19th century Turkey's Kurds have rebelled repeatedly against their Turkish masters. But no uprising has been as violent or long-lasting as that launched in 1984 by the Kurdistan Workers' Party (PKK) in its bid to unite the 25m Kurds scattered across Turkey, Iraq, Iran and Syria. Turkey's latest threat to clobber the rebels in their haven in northern Iraq has again raised the spectre of regional war. It has also concentrated attention on the PKK: who are these indomitable fighters and what is their true goal?

“Blood and Belief” offers unusual insight into the rebels' shadowy universe and, by extension, into Turkey's festering Kurdish problem. Aliza Marcus, an American journalist who was put on trial in Turkey for her reporting on the Turkish army's abuses against ordinary Kurds, charts the origins and evolution of the movement. Her scholarly, gripping account is based on interviews with, and the unpublished diaries of, former PKK militants.

Founded in 1978 by a clutch of Turkish university students, the PKK rapidly became one of the world's deadliest guerrilla armies. There are several reasons for its success. Foremost, perhaps, was Turkey's brutal suppression of Kurdish identity: the mass arrest and torture of Kurdish dissidents created fertile recruiting ground. In addition, the group had the foresight to escape to Syria before the Turkish army took over the country in 1980, allowing its forces to survive largely intact.

With Syria's blessing, the PKK sent its men and women into Lebanon's Bekaa valley for training by Palestinian militants. By the 1990s swathes of Turkey's rugged Kurdish mountainside had fallen under guerrilla control. The army's response was a scorched-earth campaign that drove more than 1m Kurdish villagers out of their homes. Robbed of its logistical base, the PKK fell into decline.

The group's fortunes were even harder hit by the capture in 1999 of its leader, Abdullah Ocalan, by Turkish secret agents in Nairobi. His subsequent recanting—he called the rebellion “a mistake” and offered to “serve the Turkish state”—is well documented. But little is known about Mr Ocalan's personal life and Ms Marcus helps to lift the veil shrouding a leader who used to shuttle between villas in Damascus and Aleppo while his fighters roughed it in the mountains. Deserters and dissidents would be summarily executed. Indeed Mr Ocalan did not hesitate to order the deaths of women and children if they were related to members of a stateemployed Kurdish militia that fought alongside the Turkish army.

“Ocalan was so convinced of his strength”, writes Ms Marcus, “that he began to believe the PKK's actions were behind many world events.” Such was his vanity that when he played football with his men, he insisted that someone kept track of each goal he scored. When one hapless militant lost count, Ocalan started shouting, “You bum, how could you forget four of my goals.”

From his island prison off the coast of Istanbul where he is serving a life sentence on treason charges, Mr Ocalan succeeded in remaining in control of his outfit—at least until the Americans occupied Iraq in 2003. Shamed by the big gains that the Iraqi Kurds made under America's protection, the PKK escalated its campaign in 2004. Whether it did so with Mr Ocalan's approval remains unclear. But it is plain that his

leadership has become increasingly symbolic and that a new generation of hardliners is gaining the upper hand.

What is missing from Ms Marcus's excellent reporting is the growing appeal of Turkey's ruling Justice and Development (AK) party to Turkish Kurds. A mixture of social-welfare schemes and Islamic piety helped AK to trounce the biggest pro-PKK party in many of its former strongholds at the general election last July. One reason for the increase in PKK militancy is to goad the government into a cross-border attack which would, in turn, drain it of its growing support among the Kurds.

Blood and Belief: The PKK and the Kurdish Fight for Independence.
By Aliza Marcus.
New York University Press; 368 pages; $35 and £22.50

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Chechnya

A soldier's tale

Nov 15th 2007
From The Economist print edition

Get article background

WAR stories are necessarily gruesome, but by any standards Arkady Babchenko's first-hand account of Russia's wars in the breakaway province of Chechnya makes harrowing reading. Within the first few pages the reader is introduced to such horrors as the taste of water tainted with rotting human flesh, the merciless beating of new recruits and the killing of a pet dog for food.

A conscript in the first Chechen war (1994-96), Mr Babchenko volunteered to fight in the second (which started in 1999) for reasons he leaves unclear. In between he gained a law degree. Unlike the provincial cannon-fodder who make up most of the Russian army, he is able to describe what he saw in lean but vivid prose. He spares nobody, least of all himself. The officers are venal, violent and incompetent, systematically pilfering the soldiers' rations. Everyone sells army munitions to the rebels at any opportunity. The soldiers are ill trained and chiefly preoccupied with finding food and shelter. The Chechen insurgents appear only as shadowy, vicious figures, slitting their captives' throats or trading them as slaves. Both sides treat civilians atrociously.

One Soldier's War in Chechnya
By Arkady Babchenko

Portobello Books; 448 pages; £16.99.

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Amazon.co.uk

Mr Babchenko dispassionately describes the resulting humiliation and brutalisation, not only his own but also of the million soldiers and support staff who have passed through the Chechen meatgrinder since 1994. Only the fierce loyalty of close pals provides a redeeming feature.

Like the murdered journalist Anna Politkovskaya, the author—who now works for *Novaya Gazeta*, in which she had a column—sees the war as a microcosm of his motherland's ills: corruption, brutality, hypocrisy and pointlessness. Like Ms Politkovskaya, he is stronger on telling bleak, startling stories than stringing them together in a structured narrative. The reader has to infer the chronology from what mostly reads like random and sometimes repetitive pages from a diary kept in the field. The lengthy snippets of soldierly conversation, salty and despairing, sound just right, though they necessarily can be only reconstructions of the real thing.

Mr Babchenko may be weak on analysis. But Russian politicians too have signally failed to answer the deep questions about their country and its people that underlie such tales of brutality.

One Soldier's War in Chechnya.
By Arkady Babchenko.
Portobello Books; 448 pages; £16.99.
To be published in America as "One Soldier's War" by Grove Press in January

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There'll always be an England

Nov 15th 2007
From The Economist print edition

Don McCullin

In England
By Don McCullin

Jonathan Cape; £35

Buy it at
Amazon.co.uk

Better known as a clear-eyed, compassionate photographer of war and disaster, Don McCullin now reveals how he sees his home country. The result is tender, funny and profoundly uncomfortable. Spread over half a century, his beautiful black-and-white pictures show a country still bleeding from the rift between poor and rich. The faces he catches are extraordinary, often disturbing. The stormy landscapes of the countryside he loves can be as alarming as battle scenes. But his jokes are great: down-at-heel Blackpool preserving its saucy postcards and its half-dozen varieties of chips for the immigrant families who now live there; toffs enjoying themselves at the Ascot races; the continuing delight of a deckchair by the sea.

In England
By Don McCullin.
Jonathan Cape; £35

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Closed books

The importance of not reading

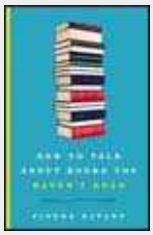
Nov 15th 2007
From The Economist print edition

“THERE is more than one way not to read, the most radical of which is not to open a book at all.” Thus begins Pierre Bayard's witty and provocative meditation on the nature, scale and necessity of non-reading. With thousands of books published every year, it is, he points out, the primary way people relate to books. And even those books they do get round to opening remain in a sense outside their knowledge. “Even as I read”, he observes, “I start to forget what I have read.”

The first section explores the four categories of unread books, into at least one of which Mr Bayard places every book he mentions. These are the “books unknown to me”, the “books I have skimmed”, the “books I have heard about” and the “books I have forgotten”. No exceptions are admitted, even for books he himself wrote.

Each category is illustrated with an example from literature. The librarian in Robert Musil's “The Man Without Qualities” explains that reading any particular book distracts from what is truly important: the relationship between all books. Paul Valéry, who eulogised Marcel Proust despite brazenly admitting he had only skimmed the writer's work, claimed this critical distance better enabled him to comment on it. Umberto Eco structured “The Name of the Rose” around a lost book which none of the characters had read, but about which each nonetheless had strong views. Montaigne, who was so forgetful that he took to annotating each book he read with a brief summary, felt that this passage to oblivion was an essential part of making a book's contents his own.

How To Talk About Books You Haven't Read
By Pierre Bayard. Translated by Jeffrey Mehlman



Bloomsbury; 208 pages; $19.95. To be published in Britain by Granta in January

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The second section describes social encounters during which it becomes essential to talk about unread books. Mr Bayard, who is a professor of French literature at the University of Paris (his book was a bestseller in France earlier this year), says airily that he must often talk about books he has at best skimmed, at worst not even opened—sometimes even with the books' authors. Should you happen to meet the writer of a book you could be expected to have read, you might find useful the advice proffered here: “While maintaining the greatest possible degree of ambiguity...tell him that you like what he wrote.”

The third and final section contains the book's meat: the “various means of extricating ourselves from these situations with grace”. The first requirement is a lack of shame; the second is the courage to impose one's own ideas on books. Then there is the most radical of all: to revel in one's freedom as a non-reader to recreate each book to one's own ideal. In any conversation about a book, says Mr Bayard, both parties are talking about different texts, “caught up in an endless process of inventing books”. Someone who finds the courage to embrace this process will find that “in that moment, he becomes a writer himself”.

Your reviewer's mind wandered, as she explored ways of not reading this book. Surely, she thought, books are like people, who can be unknown to us, or heard of, or “skimmed” (perhaps met) or forgotten, but never truly known? But that is to leave out love—for people and for books.

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Gustav Klimt

A lover of women

Nov 15th 2007 | NEW YORK
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Money and sex bolster the new fascination with Klimt's paintings

The Museum of Modern Art

Hope waiting by the studio door

WHY is Gustav Klimt, an Austrian artist who lived between 1862 and 1918, so popular? Even before its November 12th publication date in America, both the English and the German editions of the five-kilo (11lb) Klimt catalogue raisonné by Alfred Weidinger (Prestel) had sold out. And 6,000 visitors had crowded into the first week of the Klimt exhibition at New York's Neue Galerie, running from October 12th to June 30th 2008. A spokesman suggests that Klimt may be the gallery's most successful show since it opened in 2001, outstripping even Vincent van Gogh. For this there is a precedent of a kind: in the psychedelic 1960s, van Gogh's “Sunflowers” lost out to Klimt's “The Kiss” as a favourite poster in America's college dormitories.

In 1897 Klimt was one of a group of artists wanting to break free of the stuffy, constricted Old Vienna that had formed them. They established “the Secession” (stylistically allied with art nouveau). Soon everything from fashions to furniture changed as the New Vienna took shape. Klimt was the first president of the Secession and led the way sartorially too; he favoured long, voluminous indigo smocks with embroidered white epaulets. The only surviving example hangs in the exhibition, displayed rather pretentiously at the end of a narrow room with its sleeves straight out from the shoulders, cross-like.

In his lifetime and after, Klimt was acclaimed—in Vienna. In America and Britain there was little interest in German or Austrian art until well after the second world war. Klimt's appeal to hippies, and a revival of interest in art nouveau, marked the beginning of increased awareness. Much more recently he has become an international art-world star.

This is partly because of the attention given to the restitution battles over his work and the prices paid for those restituted. In 2006, after years of litigation, five paintings by Klimt once owned by Ferdinand and Adele Bloch-Bauer, two Austrian-Jewish collectors who were the painter's contemporaries, were returned to their heirs by Vienna's Belvedere museum. A sixth, still in the museum, continues to be sought by some family members.

Ronald Lauder, a founder of the Neue Galerie, was actively engaged with restitution issues for more than 20 years, advising the family as they pursued their claim. When they succeeded, Mr Lauder bought “Adele Bloch-Bauer I” for a reported $135m. But these days it is “Blooming Meadow”, which Leonard Lauder, Ronald's older brother, bought in 1983, that is in the news. Georges Jorisch, grandson of Amalie Redlich, a Viennese Jew, claims that the picture was looted from her collection after the Nazis transported her to Poland in 1941 where she is presumed to have died. The new catalogue raisonné supports this claim; Leonard Lauder steadfastly rejects it, saying he has evidence proving his legitimate ownership.

Klimt was a painter of shimmering landscapes and three of them are among the eight paintings in the Neue Galerie show. But sex is at the core of his work: women were his preoccupation.

The antechamber to the artist's studio is recreated in the exhibition. Along its far wall, next to the studio doors, is “Hope II”, pregnant with breasts exposed. Klimt never had his own home: he lived with his mother and two sisters. Nevertheless, he was a womaniser with uncalculated conquests and seven known children. No wonder Vienna buzzed with gossip about what, besides painting, went on in the studio beyond. Yet among all the photographs of the rather pudding-faced artist in the exhibition, not one captures what made him such a lady-killer.

More than 120 drawings are on view, almost all of them women, including nude lesbian couples and women apparently masturbating. But it was the portraits of society women that made his fortune. Many were commissioned by their very rich husbands, some of whom —including, it is said, Ferdinand Bloch-Bauer—were cuckolded in the process.

In 1903 the artist visited Ravenna, in Italy, where he was struck by the sixth-century Byzantine mosaic interior of the basilica of San Vitale. The glinting gold glass tiles embedded with precious and semi-precious gems must have seemed like a preview of heaven's glory to the parishioners. The Klimt portraits influenced by San Vitale look more like previews of the glories of sex. Among these, the most famous, since her restitution, is “Adele Bloch-Bauer I”. The sitter's face emerges from a gorgeous, swirling, gold-painted mosaic. She is both a beauty and a seductress. But in a photograph of her taken three years later, Mrs Bloch-Bauer seems neither beautiful nor sexy. Maybe the affair, if there was one, was over by then; it certainly must have been by 1912 when Klimt painted “Adele Bloch-Bauer II” which packs none of the first portrait's wallop.

The first Adele continues to glitter and seduce. Once Ronald Lauder became owner of the painting, it went to the Neue Galerie on long-term loan. As soon as it arrived, visitor numbers shot up by 25%.

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Sean Penn's latest film

White death

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A young man's doomed quest

“INTO the Wild”, a film directed by Sean Penn, is based on Jon Krakauer's bestseller about a young man called Christopher McCandless who gave his Harvard nest-egg to Oxfam, took to the road and eventually starved to death in Alaska in 1992. Filmed in the actual places that McCandless traversed, Mr Penn's film, written with Mr Krakauer, is about a young man in search of the absolute who is troubled by many mirages along the way, including several varieties of love.

Nature itself proves to be the last mirage: it kills him when he eats a herb that blocks his absorption of nutrients. By that time he is in the white frozen wilderness that was the obsessive object of his quest. McCandless was a follower of Thoreau, but his story is best understood as part of the tradition in which doomed quests for a hidden God end in images of uncanny whiteness. One such is the chapter on “The Whiteness of the Whale” in Herman Melville's “Moby-Dick”. Another is “The Narrative of Arthur Gordon Pym of Nantucket” by Edgar Allan Poe, with its abrupt non-ending: “And the hue of the skin of the figure was of the perfect whiteness of snow.”

Mr Penn does not appear in the films he directs but he gets memorable performances from his actors, including Emile Hirsch, who plays McCandless. Mr Hirsch is careful not to hint at a death wish: McCandless had planned to return and write a book about his experiences. This is a fine film by an American artist working at the top of his form in rarefied regions where filmmakers seldom venture.

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Norman Mailer

Nov 15th 2007
From The Economist print edition

Mickey Brennan, ScopeFeatures

Norman Mailer, pugilist of American letters, died on November 10th, aged 84

IT WAS on the Dick Cavett show in 1971 that Mailer (always “Mailer” in his writings; “Mister” was needless polish and priming), three-tumblers drunk, angry, little eyes blue as a touchpaper, was needled by Gore Vidal into saying this:

> In Hemingway's time there were great writers...Our time has been much more complicated and there hasn't been that many really extraordinary writers around, and I have presumed with all my extraordinary arrogance and loutishness and crudeness to step forth and say, “I'm going to be the champ until one of you knocks me off.” Well, fine, but, you know, they don't knock you off because they're too damned simply yellow, and they kick me in the nuts, and I don't like it.

He had only half got going, but then the commercial came in. Much more could have been said. How Mailer had written what George Orwell called the best-ever book about the second world war, “The Naked and the Dead”. How he had won a Pulitzer for “The Armies of the Night”, the story of the 1968 anti-war march on the Pentagon, and every other book prize going except the Nobel. How, despite the critical bile spewed over much of his fiction, he still had germinating in him the Great American Novel that would out-Tolstoy Tolstoy and out-Dickens Dickens. How he had invented, with a nod to Truman Capote, the non-fiction novel and the novelised news report, through both of which strolled his best character, Mailer, with his crinkly electrified hair and his maudlin writer's hang-ups, continually “in an intimate dialogue, a veritable dialectic with the swoops, spooks, starts, the masks and snarls, the calm lucid abilities of sin...his tonic, his jailer, his horse, his sword”.

Mailer was brave. That was his virtue of virtues. In the 1950s he disdained “the stench of fear that has come out of every pore of American life...a collective failure of nerve”. He smelled fear in the dark, rotting jungle mud where he had fought as a soldier in the Philippines, in the blood, shit and slobber of the Chicago stockyards, but also at Washington parties, among his own stupid bouts of tongue-tiedness and circumlocution, as “the hard gemlike flame of bourbon” burned through him. At such points he would be rescued by the wild man Mailer, a creature “who would have been admirable, except that he was an absolute egomaniac, a Beast”.

Gristle and gravel

He talked and wrote of fighting more than he did it. Short and stocky, he was liable to be upended pretty fast. But he boxed a bit, and proudly jogged once with Muhammad Ali until his breath gave out. Instinctively, he put up his fists. In 1957, in an essay called “The White Negro”, he recommended that white Americans should live like inner-city blacks, hip and cool as cats on the edge of violence, rather than fall into the deadness of post-war conformity.

The shock tactics sometimes misfired badly. He stuck a kitchen knife (or a pair of scissors, or a “three-inch dirty penknife”) into the neck of his second wife, the second of six, all of whom loved and forgave him as long as their alimony was paid. He acted as literary sponsor to a talented murderer, Jack Abbott, who murdered again when Mailer had helped to get him out of jail. He revelled in gross, boastful or mechanical descriptions of sex (“a hard punishing session with pulley weights, stationary bicycle and ten breath-seared laps round the track”), not least because this outraged the women's libbers with whom, in the 1970s, he was permanently at war. Once Mailer, with a sparkle in his eye that was maybe aggression, maybe fun, acting his usual part of the hollering Jewish leprechaun, proclaimed that all women should be locked in cages.

On form (as in “Miami and the Siege of Chicago”, about the 1968 political conventions, or “Of a Fire on the Moon”, about the first moon landing) he was a gloriously evocative, generous, sprawling writer, worthy of the scale of his country and his subjects. But Mailer dismissed these books as journalism, that ceaseless scavenging for “tidbits, gristle, gravel, garbage cans, charlotte russe, old rubber tyres, T-bone steaks” that went to feed “that old American goat, our newspapers”. Despite his founder-role on the radical *Village Voice*, he took little pride in that craft. The Great Novel was his quest: a quest that became weirder and more abstruse over time, taking him to Pharaoic Egypt and the corridors of the CIA and inserting Mailer (sometimes the very Son of God, sometimes the Devil) into the made-up lives of Jesus and Hitler.

By general consent, though not by Mailer's, his best book was “The Executioner's Song” of 1979. It won him his second Pulitzer. In it he told the story of Gary Gilmore, the first man to be executed after the ending of the moratorium on the death penalty, in sentences as spare and unadorned as the Utah desert in which it was set. The style was almost reminiscent of his great hero, Hemingway. Those short, declarative sentences, he wrote once, had a suicide's dread in their silences: dread that “at any instant, by any failure in magic, by a mean defeat, or by a moment of cowardice, Hemingway could be thrust back again into the agonising demands of his courage.” Mailer's short sentences carried a more pugnacious message: he was the champ, and would be until someone braver and better knocked him off.

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Overview

Nov 15th 2007
From The Economist print edition

Japan's GDP rose by 0.6% in the third quarter, to stand 2.1% higher than in the same quarter of 2006.

The GDP of the **euro area** increased by 0.7% in the third quarter. It was 2.6% higher than a year before. **America's** trade deficit in goods and services narrowed to $56.5 billion in September, $7.7 billion less than a year before. Exports were up by 13.6% and imports by 4.9%, compared with the previous year. Consumer confidence in **America** is at its weakest level since the aftermath of Hurricane Katrina, according to the University of Michigan's index, which fell to 75 in November from 80.9 in October. The value of retail sales rose by 0.2% in October, to be 5.2% higher than a year earlier. **China's** trade surplus rose to a record high of $27.1 billion in October, 13.6% higher than a year before. Consumer-price inflation went up to 6.5%, from 6.2% in September. The central bank raised the share of deposits that banks are required to hold with it by 0.5 percentage points to 13.5%. **Britain's** inflation rate increased to 2.1% in the year to October, from 1.8% in September. The Bank of England said it expected inflation to stay above the 2% target rate in the short term. Consumer prices in **Sweden** rose by 2.7% in the year to October. September's inflation rate was 2.2%.

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Output, prices and jobs

Nov 15th 2007
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2007†	2008†	latest	latest	year ago	2007†	rate‡, %
United States	+2.6 Q3	+3.9	+2.0	+2.1	+1.9 Sep	+2.8 Sep	+2.1	+2.8	4.7 Oct
Japan	+2.1 Q3	+2.6	+2.0	+1.8	+0.8 Sep	–0.2 Sep	+0.6	nil	4.0 Sep
China	+11.5 Q3	na	+11.5	+10.0	+17.9 Oct	+6.5 Oct	+1.4	+4.5	9.5 2006
Britain	+3.3 Q3	+3.2	+3.0	+2.1	–0.3 Sep	+2.1 Oct§	+2.4	+2.2	5.4 Sep††
Canada	+2.5 Q2	+3.6	+2.6	+2.3	+0.2 Aug	+2.5 Sep	+0.7	+2.2	5.8 Oct
Euro area	+2.6 Q3	+2.8	+2.6	+2.0	+3.5 Sep	+2.6 Oct	+1.6	+2.0	7.3 Sep
Austria	+3.4 Q3	+3.2	+3.2	+2.6	+7.5 Aug	+2.8 Oct	+1.2	+1.9	4.2 Oct
Belgium	+2.5 Q3	+1.6	+2.6	+2.0	+4.1 Aug	+2.2 Oct	+1.2	+1.7	11.4 Sep‡‡
France	+2.1 Q3	+2.9	+1.8	+1.9	+1.6 Sep	+1.5 Sep	+1.2	+1.4	8.1 Q2
Germany	+2.5 Q3	+2.8	+2.6	+2.1	+6.1 Sep	+2.4 Oct	+1.1	+2.1	8.7 Oct
Greece	+3.6 Q3	na	+3.8	+3.0	+1.7 Sep	+3.1 Oct	+2.8	+2.6	8.4 Jun
Italy	+1.9 Q3	+1.5	+1.7	+1.4	+0.3 Sep	+2.1 Oct	+1.8	+1.9	6.0 Q2
Netherlands	+4.1 Q3	+7.2	+2.5	+2.2	+2.3 Sep	+1.6 Oct	+1.1	+1.7	4.3 Oct††
Spain	+3.8 Q3	+2.8	+3.7	+2.7	+0.6 Sep	+3.6 Oct	+2.5	+2.6	8.0 Sep
Czech Republic	+6.0 Q2	+5.7	+5.7	+4.5	+1.2 Sep	+4.0 Oct	+1.3	+2.6	5.8 Oct
Denmark	+0.6 Q2	–1.6	+1.6	+1.7	–0.6 Sep	+1.7 Oct	+1.5	+1.6	3.1 Sep
Hungary	+1.0 Q3	+1.2	+2.1	+3.0	+8.7 Sep	+6.7 Oct	+6.3	+7.8	7.2 Sep††
Norway	+3.9 Q2	+3.5	+3.3	+2.6	+0.3 Sep	–0.2 Oct	+2.7	+0.4	2.5 Aug††
Poland	+6.4 Q2	na	+6.5	+5.2	+5.2 Sep	+3.0 Oct	+1.2	+2.1	11.6 Sep‡‡
Russia	+7.8 Q2	na	+7.2	+6.4	+3.0 Sep	+9.5 Sep	+9.5	+8.6	6.0 Sep‡‡
Sweden	+3.5 Q2	+3.7	+3.4	+3.0	+1.1 Sep	+2.7 Oct	+1.3	+1.8	5.7 Oct‡‡
Switzerland	+2.8 Q2	+3.0	+2.6	+2.0	+9.8 Q2	+1.2 Oct	+0.3	+0.6	2.6 Oct‡‡
Turkey	+3.9 Q2	na	+5.2	+5.1	+2.2 Sep	+7.0 Oct	+10.0	+8.5	9.2 Q3‡‡
Australia	+4.3 Q2	+3.8	+4.2	+3.7	+4.6 Q2	+1.9 Q3	+3.9	+2.4	4.3 Oct
Hong Kong	+6.6 Q2	+7.8	+6.1	+4.5	–2.3 Q2	+1.6 Sep	+2.1	+2.0	4.1 Sep††
India	+9.3 Q2	na	+8.0	+7.9	+6.4 Sep	+6.4 Sep	+6.8	+6.2	7.6 2006
Indonesia	+6.5 Q3	na	+6.2	+6.1	+4.3 Aug	+6.9 Oct	+6.3	+6.3	9.8 Feb
Malaysia	+5.7 Q2	na	+6.0	+5.8	+3.4 Sep	+1.8 Sep	+3.3	+2.1	3.4 Q2
Pakistan	+7.0 2007**	na	+6.4	+5.9	+9.3 Aug	+8.4 Sep	+8.7	+6.9	6.2 2006
Singapore	+9.4 Q3	+6.4	+7.4	+4.9	–2.8 Sep	+2.7 Sep	+0.4	+1.8	1.7 Q3
South Korea	+5.2 Q3	+1.4	+5.0	+4.7	+0.3 Sep	+3.0 Oct	+2.2	+2.5	3.2 Sep
Taiwan	+5.1 Q2	na	+4.3	+4.4	+8.1 Sep	+5.3 Oct	–1.2	+1.1	3.9 Sep
Thailand	+4.4 Q2	+5.2	+4.5	+4.9	+9.2 Sep	+2.5 Oct	+2.8	+2.0	1.2 Aug
Argentina	+8.7 Q2	+8.8	+8.0	+5.9	+1.5 Sep	+8.4 Oct	+10.5	+8.9	8.5 Q2‡‡
Brazil	+5.4 Q2	+3.2	+4.7	+4.5	+5.6 Sep	+4.1 Oct	+3.3	+3.6	9.0 Sep‡‡
Chile	+6.1 Q2	+6.5	+5.8	+5.2	+1.3 Sep	+6.5 Oct	+2.1	+3.9	7.7 Sep††‡‡
Colombia	+6.9 Q2	+4.4	+6.7	+5.6	+7.7 Aug	+5.2 Oct	+4.2	+5.5	10.6 Sep‡‡
Mexico	+2.8 Q2	+5.3	+3.0	+2.9	+0.4 Sep	+3.7 Oct	+4.3	+4.0	3.9 Sep‡‡
Venezuela	+8.9 Q2	na	+6.9	+4.8	+14.1 Jul	+17.2 Oct	+15.5	+17.8	8.4 Q2‡‡
Egypt	+7.2 Q2	na	+7.0	+7.3	+7.5 2007**	+7.5 Oct	+11.8	+8.8	9.0 Q3‡‡
Israel	+4.4 Q2	+6.1	+5.3	+4.4	+2.3 Aug	+1.4 Sep	+1.3	+0.4	7.6 Q2
Saudi Arabia	+4.3 2006	na	+4.8	+5.6	na	+4.9 Sep	+2.5	+3.4	na
South Africa	+5.0 Q2	+4.5	+4.7	+5.1	–1.4 Sep	+7.2 Sep	+5.3	+6.0	25.5 Mar‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	+6.4 Q3	+7.4	+7.9	+5.3	+5.8 Sep	+8.5 Oct	+3.7	+6.1	5.5 Aug
Finland	+4.7 Q2	+3.8	+4.6	+2.5	+1.1 Sep	+2.7 Oct	+1.8	+2.7	6.9 Sep
Iceland	+2.5 Q2	+9.1	+1.8	+2.1	+7.6 2006	+5.2 Nov	+7.3	+4.9	0.8 Sep‡‡
Ireland	+5.4 Q2	–5.5	+4.7	+3.5	+4.3 Sep	+4.6 Sep	+4.0	+4.7	4.8 Oct
Latvia	+11.1 Q3	na	+10.0	+7.5	nil Sep	+13.2 Oct	+5.6	+9.6	5.5 Aug
Lithuania	+10.8 Q3	+10.0	+7.8	+6.9	na	+7.6 Oct	+3.6	+5.4	2.8 Sep
Luxembourg	+5.3 Q2	+5.3	+5.0	+3.4	–2.0 Aug	+2.9 Oct	+1.5	+2.1	4.2 Sep‡‡
New Zealand	+3.8 Q2	+3.4	+3.1	+2.8	+0.5 Q2	+1.8 Q3	+3.5	+2.5	3.5 Q3
Peru	+6.5 Aug	na	+7.5	+6.5	+7.0 Aug	+3.1 Oct	+1.9	+1.7	8.0 Aug‡‡
Philippines	+7.5 Q2	+7.1	+6.9	+5.0	–4.7 Aug	+2.7 Oct	+5.4	+2.7	7.8 Q3‡‡
Portugal	+1.8 Q3	nil	+1.8	+2.0	+1.4 Sep	+2.1 Sep	+3.0	+2.4	7.9 Q2‡‡
Slovakia	+9.4 Q3	na	+8.5	+6.5	+15.4 Sep	+3.3 Oct	+3.7	+2.7	8.3 Sep
Slovenia	+5.9 Q2	na	+5.6	+4.6	+2.9 Sep	+5.1 Oct	+1.5	+3.2	7.4 Aug‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions. §RPI inflation rate 4.2% in Oct. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. §§New series.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

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The Economist commodity-price index

Nov 15th 2007
From The Economist print edition

The Economist commodity-price index

2000=100

	Nov 6th	Nov 13th*	% change on one month	% change on one year
Dollar index				
All items	217.1	212.7	−1.3	+16.7
Food	196.7	193.7	+0.1	+28.4
Industrials				
All	243.6	237.3	−2.7	+6.5
Nfa†	175.8	175.6	+5.9	+31.1
Metals	280.6	271.1	−5.4	−0.1
Sterling index				
All items	157.7	155.7	−3.2	+6.7
Euro index				
All items	138.0	134.7	−4.3	+2.4
Gold				
$ per oz	823.30	799.60	+5.4	+28.8
West Texas Intermediate				
$ per barrel	96.43	91.40	+4.5	+56.7

*Provisional †Non-food agriculturals.

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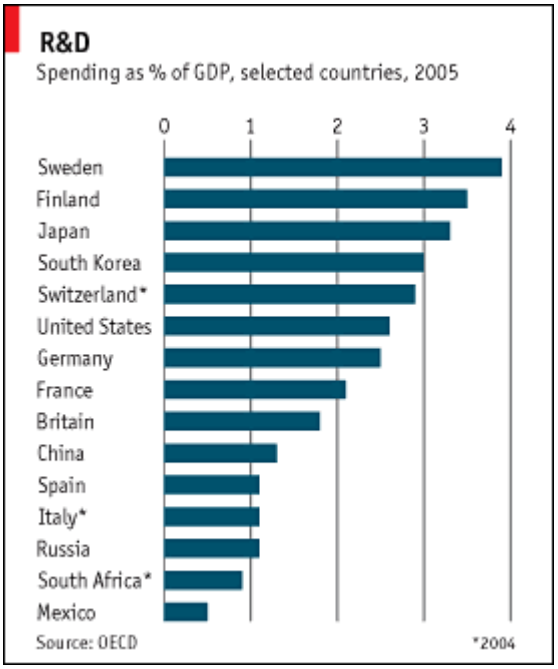
R&D

Nov 15th 2007
From The Economist print edition



Spending on research and development in the 30 mainly rich countries of the OECD was $771.5 billion, or 2.25% of total GDP, in 2005, according to a new report by the organisation. Sweden, Finland and Japan were the only countries who spent more than 3% of GDP. Overall, the annual growth rate of R&D expenditure shrank by more than half to 2.2% in 2001-05 compared with 1995-2001. However, the growth rates in America, Japan and the European Union have remained similar since the mid-1990s, at about 2.9% a year. Among non-OECD countries, China's research spending was as much as half that of the EU and has grown at an annual rate of 18% since 2000. Businesses paid for more than 68% of R&D in the OECD.

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Trade, exchange rates, budget balances and interest rates

Nov 15th 2007
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2007†	Currency units, per $ Nov 14th	Currency units, per $ year ago	Budget balance % of GDP 2007†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−805.0 Sep	−793.2 Q2	−5.5	–	–	−1.2	4.45	4.27
Japan	+104.0 Sep	+205.0 Sep	+4.7	111	118	−2.6	0.73	1.52
China	+256.5 Oct	+249.9 2006	+10.9	7.43	7.87	0.2	4.28	4.86
Britain	−164.4 Sep	−86.6 Q2	−3.3	0.48	0.53	−3.0	6.21	4.75
Canada	+48.4 Sep	+21.9 Q2	+1.7	0.96	1.14	1.0	4.00	4.20
Euro area	+42.1 Aug	+30.4 Aug	+0.1	0.68	0.78	−0.9	4.58	4.14
Austria	+1.5 Aug	+12.3 Q2	+2.9	0.68	0.78	−0.5	4.58	4.24
Belgium	+17.6 Aug	+13.0 Jun	+2.4	0.68	0.78	−0.1	4.64	4.30
France	−44.4 Sep	−25.8 Aug	−1.1	0.68	0.78	−2.4	4.58	4.25
Germany	+258.7 Sep	+204.5 Sep	+5.6	0.68	0.78	−0.4	4.58	4.13
Greece	−51.1 Aug	−40.9 Aug	−10.5	0.68	0.78	−2.5	4.58	4.44
Italy	−15.0 Aug	−51.4 Aug	−2.5	0.68	0.78	−2.5	4.58	4.46
Netherlands	+49.9 Aug	+57.2 Q3	+7.8	0.68	0.78	−0.6	4.58	4.24
Spain	−124.1 Aug	−125.1 Jul	−9.1	0.68	0.78	1.8	4.58	4.28
Czech Republic	+3.5 Sep	−5.8 Sep	−3.5	18.1	21.9	−3.9	3.73	4.55
Denmark	+3.9 Sep	+4.0 Sep	+1.9	5.07	5.82	3.8	4.80	4.23
Hungary	−1.4 Sep	−6.8 Q2	−5.8	173	201	−6.0	7.41	6.50
Norway	+54.7 Oct	+54.6 Q2	+14.3	5.39	6.44	18.9	5.72	4.78
Poland	−10.5 Aug	−15.5 Sep	−4.3	2.48	2.97	−2.0	5.30	5.69
Russia	+121.5 Sep	+73.5 Q3	+5.6	24.5	26.7	4.0	10.00	6.32
Sweden	+18.3 Sep	+29.7 Q2	+7.1	6.28	7.08	2.8	3.92	4.24
Switzerland	+11.1 Sep	+64.9 Q2	+16.3	1.12	1.25	0.3	2.75	2.87
Turkey	−56.9 Sep	−34.4 Sep	−7.3	1.17	1.45	−2.8	17.33	6.36‡
Australia	−13.6 Sep	−47.1 Q2	−5.7	1.11	1.31	1.6	7.14	6.12
Hong Kong	−21.1 Sep	+24.9 Q2	+9.7	7.79	7.79	1.9	3.41	3.45
India	−65.4 Sep	−9.7 Q2	−1.2	39.3	45.3	−3.3	7.29	8.22
Indonesia	+41.3 Sep	+11.0 Q2	+2.4	9,220	9,183	−1.7	8.14	6.60‡
Malaysia	+29.2 Sep	+27.6 Q2	+13.8	3.35	3.65	−3.2	3.62	4.74‡
Pakistan	−15.0 Oct	−7.1 Q2	−4.5	61.1	60.8	−4.6	9.81	9.18‡
Singapore	+38.5 Sep	+41.6 Q2	+27.4	1.45	1.56	0.3	2.50	2.83
South Korea	+19.7 Oct	+9.1 Sep	+0.4	914	941	0.4	5.35	5.41
Taiwan	+15.7 Oct	+28.3 Q2	+6.4	32.3	32.8	−2.0	2.60	2.78
Thailand	+10.7 Sep	+11.8 Sep	+3.6	33.9	36.6	−1.9	3.55	4.64
Argentina	+10.5 Sep	+7.4 Q2	+2.8	3.13	3.07	1.4	14.44	na
Brazil	+42.6 Oct	+9.0 Sep	+0.7	1.74	2.15	−1.8	11.18	6.16‡
Chile	+24.7 Oct	+8.3 Q2	+5.0	505	529	8.0	5.88	4.86‡
Colombia	−1.9 Aug	−4.8 Q2	−3.0	2,031	2,273	−0.2	8.65	6.00‡
Mexico	−1.2 Sep	−7.0 Q2	−0.6	10.9	10.9	nil	7.41	7.99
Venezuela	+23.8 Q2	+20.4 Q2	+7.7	2,147	3,029	−2.2	11.19	6.55‡
Egypt	−15.8 Q2	+2.7 Q2	+2.3	5.52	5.72	−5.5	6.71	5.32‡
Israel	−9.5 Oct	+7.8 Q2	+3.7	3.93	4.31	−0.5	4.24	5.09
Saudi Arabia	+146.6 2006	+98.9 2006	+23.8	3.74	3.75	19.1	4.78	na
South Africa	−11.0 Sep	−17.4 Q2	−6.3	6.62	7.28	0.5	10.90	8.21
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Estonia	−4.1 Aug	−3.1 Aug	−14.6	10.7	12.2	3.1	5.23	na
Finland	+12.5 Aug	+13.3 Sep	+7.1	0.68	0.78	4.2	4.45	4.24
Iceland	−1.8 Oct	−3.7 Q2	−16.9	59.8	70.3	5.3	14.13	na
Ireland	+36.7 Aug	−10.5 Q2	−4.9	0.68	0.78	1.1	4.58	4.32
Latvia	−6.7 Sep	−6.3 Aug	−22.2	0.48	0.54	0.4	10.26	na
Lithuania	−6.6 Sep	−4.5 Sep	−14.5	2.35	2.70	−0.5	6.49	na
Luxembourg	−5.8 Aug	+4.6 Q2	na	0.68	0.78	0.3	4.58	na
New Zealand	−4.4 Sep	−9.2 Q2	−8.1	1.31	1.52	4.8	7.50	6.52
Peru	+8.6 Aug	+2.8 Q2	+1.1	3.00	3.23	0.7	4.95	na
Philippines	−4.1 Aug	+6.4 Jun	+5.9	42.9	50.1	−0.9	6.50	na
Portugal	−23.8 Aug	−18.1 Aug	−8.5	0.68	0.78	−3.3	4.58	4.37
Slovakia	−2.9 Aug	−3.8 Jul	−4.4	22.5	27.9	−2.9	4.20	4.62
Slovenia	−2.6 Sep	−1.4 Aug	−3.2	0.68	0.78	−0.5	na	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

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Markets

Nov 15th 2007
From The Economist print edition

Markets

	Index Nov 14th	% change on one week	% change on Dec 29th 2006 in local currency	% change on Dec 29th 2006 in $ terms
United States (DJIA)	13,231.0	–0.5	+6.2	+6.2
United States (S&P 500)	1,470.6	–0.3	+3.7	+3.7
United States (NAScomp)	2,644.3	–3.8	+9.5	+9.5
Japan (Nikkei 225)	15,499.6	–3.7	–10.0	–3.7
Japan (Topix)	1,497.7	–3.8	–10.9	–4.7
China (SSEA)	5,682.5	–3.4	+101.9	+112.2
China (SSEB, $ terms)	344.8	–6.7	+152.1	+165.0
Britain (FTSE 100)	6,432.1	+0.7	+3.4	+9.1
Canada (S&P TSX)	13,774.5	–2.4	+6.7	+29.9
Euro area (FTSE Euro 100)	1,367.8	–1.4	+7.0	+19.2
Euro area (DJ STOXX 50)	4,338.3	–1.4	+5.3	+17.3
Austria (ATX)	4,500.4	–3.1	+0.8	+12.3
Belgium (Bel 20)	4,142.7	–2.5	–5.6	+5.2
France (CAC 40)	5,613.6	–1.2	+1.3	+12.8
Germany (DAX)*	7,783.1	–0.2	+18.0	+31.4
Greece (Athex Comp)	5,177.1	–2.4	+17.8	+31.3
Italy (S&P/MIB)	38,586.0	–1.8	–6.9	+3.7
Netherlands (AEX)	512.3	–3.4	+3.4	+15.2
Spain (Madrid SE)	1,712.1	–0.2	+10.1	+22.7
Czech Republic (PX)	1,828.3	–2.3	+15.1	+32.4
Denmark (OMXCB)	465.4	–3.1	+9.7	+22.3
Hungary (BUX)	26,479.7	–2.1	+6.6	+17.6
Norway (OSEAX)	576.4	–3.9	+14.7	+32.5
Poland (WIG)	57,384.0	–4.3	+13.8	+33.2
Russia (RTS, $ terms)	2,244.1	–1.6	+8.5	+16.8
Sweden (Aff.Gen)	352.4	–2.6	–3.5	+5.2
Switzerland (SMI)	8,631.0	–0.8	–1.8	+7.0
Turkey (ISE)	55,664.9	–0.7	+42.3	+72.0
Australia (All Ord.)	6,650.0	–1.2	+17.8	+33.8
Hong Kong (Hang Seng)	29,166.0	–1.8	+46.1	+45.9
India (BSE)	19,929.1	+3.3	+44.6	+62.7
Indonesia (JSX)	2,691.9	–0.8	+49.1	+45.4
Malaysia (KLSE)	1,384.6	–2.1	+26.3	+33.2
Pakistan (KSE)	13,315.6	–1.4	+32.6	+32.1
Singapore (STI)	3,524.9	–4.0	+18.1	+25.2
South Korea (KOSPI)	1,972.6	–3.5	+37.5	+40.0
Taiwan (TWI)	8,942.9	–3.8	+14.3	+15.4
Thailand (SET)	861.5	–2.1	+26.7	+35.3
Argentina (MERV)	2,309.4	+0.5	+10.5	+8.2
Brazil (BVSP)	64,630.0	+1.8	+45.3	+78.7
Chile (IGPA)	14,674.8	+0.6	+18.6	+25.0
Colombia (IGBC)	10,959.7	+0.7	–1.8	+8.3
Mexico (IPC)	29,655.7	+0.2	+12.1	+11.7
Venezuela (IBC)	38,355.2	–1.8	–26.6	+14.3
Egypt (Hermes)	82,839.6	+0.4	+35.2	+39.8
Israel (TA-100)	1,154.3	–1.9	+25.2	+34.5
Saudi Arabia (Tadawul)	9,264.8	+2.3	+16.8	+17.1
South Africa (JSE AS)	30,681.7	–0.3	+23.1	+31.2
Europe (FTSEurofirst 300)	1,522.7	–1.4	+2.6	+14.4
World, dev'd (MSCI)	1,607.9	–1.4	+8.4	+8.4
Emerging markets (MSCI)	1,279.9	–1.8	+40.2	+40.2
World, all (MSCI)	408.8	–1.4	+11.1	+11.1
World bonds (Citigroup)	731.0	+0.5	+11.0	+11.0
EMBI+ (JPMorgan)	429.8	nil	+5.5	+5.5
Hedge funds (HFRX)	1,340.2	–1.6	+5.0	+5.0
Volatility, US (VIX)	25.9	26.5	11.6	(levels)
CDSs, Eur (iTRAXX)†	51.9	+10.4	+122.6	+148.0
CDSs, N Am (CDX)†	78.0	–1.7	+133.3	+133.3
Carbon trading (EU ETS) €‡	22.9	+5.3	+25.6	+39.9

*Total return index. †Credit-default swap spreads, basis points.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CME; Danske Bank; EEX; HKMA; Markit; Standard Bank

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Trade logistics

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The ability of developing countries to connect firms, suppliers and consumers to global supply chains efficiently is essential to their competitiveness, says the World Bank in a new study on trade logistics. The study ranks countries on an index which combines seven measures of logistics performance, including the efficiency of customs procedures, costs, and the quality of infrastructure. Developed countries all score highly; Singapore comes top. Those developing countries where trade is central to economic performance, such as China and Chile, tend to be ranked higher than others with similar incomes. Some higher-income countries, such as the oil producers, tend to perform below their peers.

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